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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 359

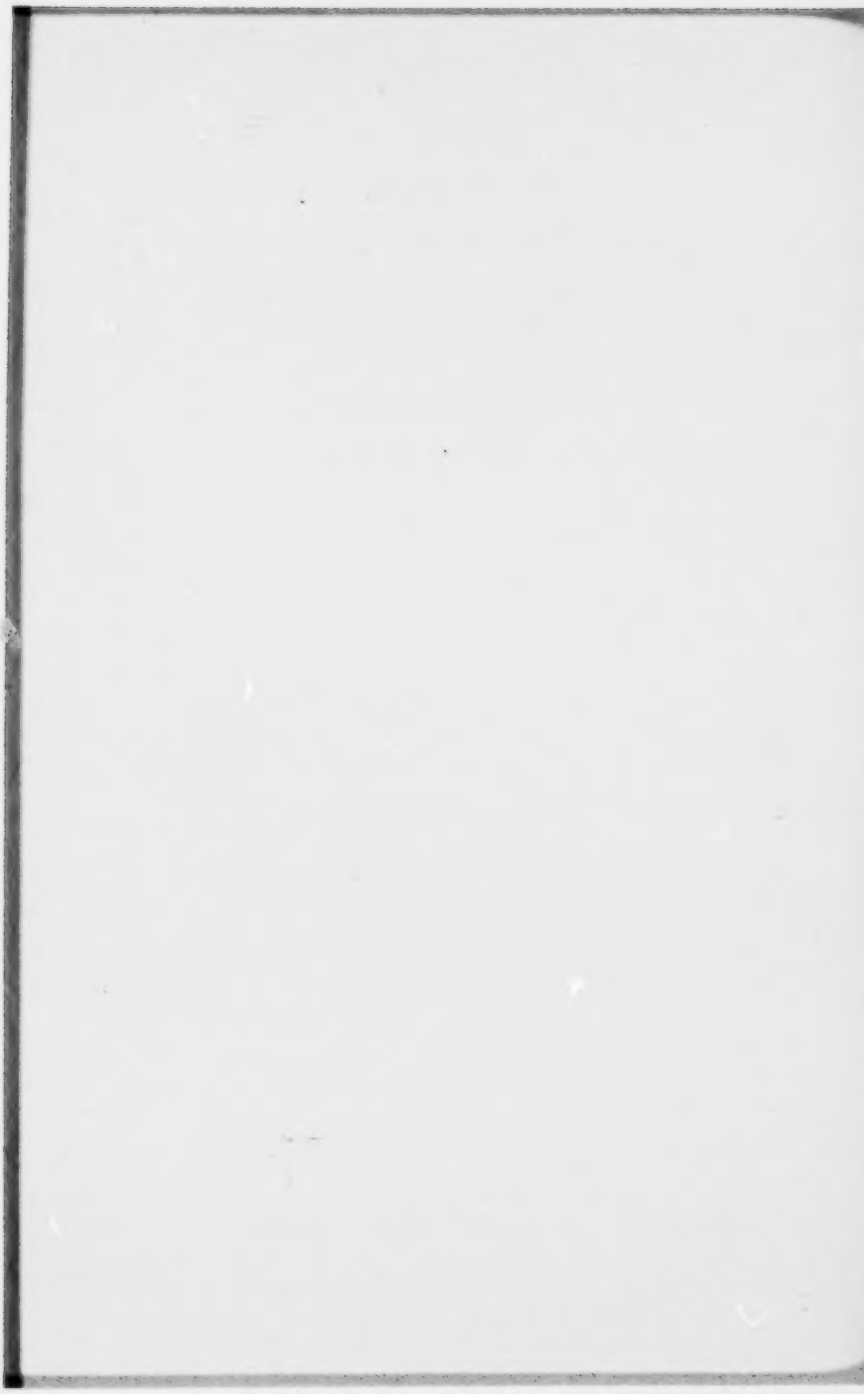
STOCKHOLDERS' COMMITTEE OF THE UNIVERSAL LUBRICATING SYSTEMS, INC.,
Petitioner,

vs.

AUSTIN L. STALEY, TRUSTEE IN REORGANIZATION FOR THE UNIVERSAL LUBRICATING SYSTEMS, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

S. WALLACE DEMPSEY,
W. C. MCCLURE,
Counsel for Petitioner.



INDEX

Subject Index

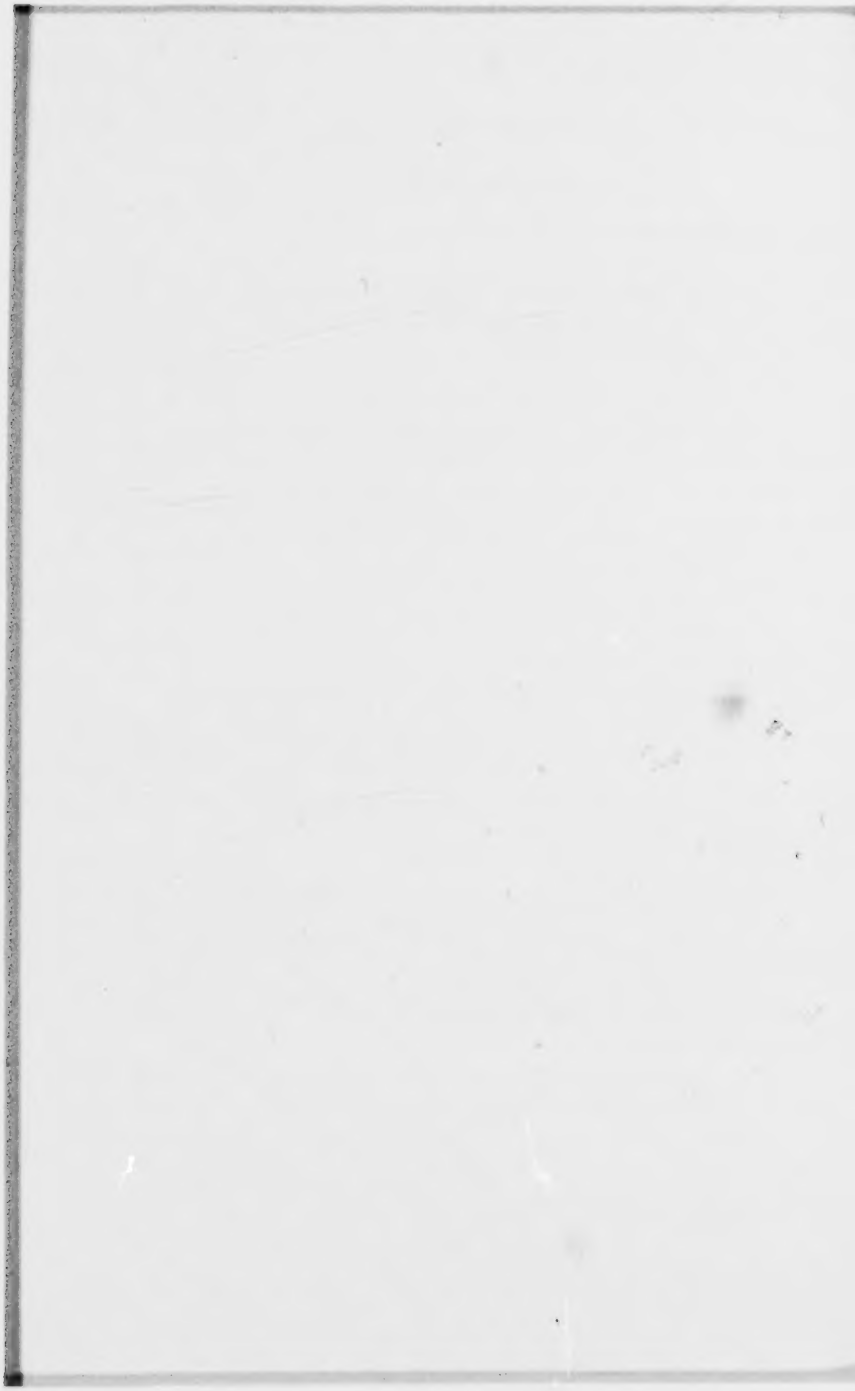
	Page
Petition for a writ of certiorari	1
Jurisdiction	2
Summary statement of the matters involved	2
Reasons relied on for the allowance of writ	12
Brief in support of petition	16

Table of Cases Cited

Consolidated Rock Co. v. *Dubois*, 312 U. S. 510	17, 19
Dudley v. *Mealey*, 147 F. (2d) 268	17
Eastman Co. v. *So. P. Co.*, 273 U. S. 359	20
Federal Power Comm. v. *Hope Nat'l Gas Co.*, 320 U. S. 591	16
Galveston H. & S. R. Co. v. *Texas*, 210 U. S. 217	17
Group of Institutional Investors v. *Chicago, M. St. P. & P. R. Co.*, 318 U. S. 523	16, 17
Pollard v. *Lyon*, 91 U. S. 308	21
Puget Sound Power & Light Co. v. *City of Puyallup*, 51 F. (2d) 688	17, 19
U. S. v. *Bethlehem Steel Co.*, 315 U. S. 328	21, 22

Statutes and Authorities Cited

Bankruptcy, Chapter X	15
Corpus Juris Secundum:	
Vol. 30, Sec. 104, p. 506	20
Vol. 37, Sec. 144, p. 489	21
Jones on Evidence:	
Second Ed., Sec. 1005, p. 1847	18, 20
Third Ed., Sec. 272, p. 405	21
United States Code:	
Title 11, Section 616	13
Title 28, Section 347	2



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STOCKHOLDERS' COMMITTEE OF THE UNIVERSAL LUBRICATING SYSTEMS, INC.,

Petitioner,

vs.

AUSTIN L. STALEY, TRUSTEE IN REORGANIZATION FOR THE UNIVERSAL LUBRICATING SYSTEMS, INC.

PETITION OF STOCKHOLDERS' COMMITTEE OF THE ABOVE-NAMED DEBTOR

To the Honorable Harlan Fiske Stone, Chief Justice, and the Associate Justices of the United States Supreme Court:

This is an application by a Stockholders' Committee of the above named Debtor for a writ of certiorari for a review of the decree of the United States Circuit Court of Appeals for the Third Circuit affirming a decree of the United States District Court for the Western District of Pennsylvania, approving a plan for the reorganization of the above named corporation.

Jurisdiction

The Petitioners respectfully show that jurisdiction arises herein under the Statute set out as Section 347 of Title 28, U. S. C.

A. Summary Statement of the Matters Involved

Debtor (hereinafter called Universal), was formed to manufacture lubricating appliances invented by Gerald S. Rogers, only to find continuous, persistent opposition to the marketing of its products by Stewart-Warner Corporation, which had long enjoyed a monopoly of such appliances. From 1932 to 1941, Stewart-Warner brought many patent suits against Universal Lubricating Systems, Inc., charging enfringements by it, and all of these suits (excepting the present pending litigation), have been determined favorably to Universal (App. pp. 92a, 93a), the losses of Universal from which amount to $2,000,000.00 (App., pp. 125a, 130a). Stewart-Warner has made profits through its unfair competition sought to be recovered in the pending action, in addition to the losses (Id. 126a). After Universal suffered these huge losses (through Stewart-Warner's unfair competition), in May, 1936, it obtained loans from one Brynoldt on an Agreement that, if his loans exceeded $20,000.00, all Debtor's machinery, materials and manufactured stock should become Brynoldt's property. In 1937, his indebtedness exceeded $20,000, whereupon he claimed absolute title to all Debtor's machinery, materials and manufactured stock, and exacted a Bill of Sale, and attempted to secure possession and to exercise all rights of ownership, including leasing its own property to the Universal for three (3) years and eleven (11) months at a rental of $23,500, payable $500 per month, plus 6% interest (Plan p. 49).

The property claimed consists of 148 items (Plan p. 55), and is practically the same as that which the Master found to be worth $327,000.

Brynoldt acquired, in addition, title to patents owned by Debtor, the coupler patent alone being worth $40,000, and he acquired 75 shares of preferred and 3800 shares of common stock,—all, so far as appears for the $23,500 (Id.). Brynoldt and his attorney, with a third person, filed the Petition in Bankruptcy herein. The Trustee believes there is but remote possibility that Brynoldt could sustain his claim of absolute ownership (July M. R. Para. 25).

The issue litigated herein is whether the Debtor is solvent and its stockholders entitled to rights in the reorganized company. The evidence on this issue was as follows:

(1) No creditor appeared at the hearings before the Master or the District Judge (except Brynoldt), but the contentions of the creditors were presented and urged by the Trustee and his attorney.

(2) Universal's tangible assets, excepting its claims against Stewart-Warner and Brynoldt, and excepting a valuable patent, were appraised on behalf of the Trustee for the creditors, and also separately on behalf of the Stockholders' Committee, with the result that,—

The Committee's valuation was . . . $375,078.58; and the Trustee's valuation for the Creditors was . . . $279,719.20.

The Master did not find that the Trustee's valuation was more dependable than that made for the Committee, but gave the Trustee's valuation the benefit of three-fourths (¾) of the difference between the two valuations, and found the value of this part of the tangible property not to exceed . . . . . $300,000.

(July Master's Report, hereinafter called July M. R., Para. 6, p. 25a, 26a).

From July To October, 1944, Debtor's physical assets increased in value ..... $27,000. (October Master's Report, hereinafter called Oct. M. R., p. 60a, 61a).

(3) *The Master, the District Judge and the Circuit Court of Appeals refused to find that the Stewart-Warner claim had a value, proof as to which claim was as follows:*

Certain proof as to the Stewart-Warner claim is stated above. In addition, Universal's attorney in the pending action, seeking to recover the estimated damages, states that he believes them to be $2,000,000 (125a, 126a, 130a), and that he is entirely satisfied that he can prove liability "up to the hilt" (127a).

It is stated in the Plan that,— * * * "that litigation, (with Stewart-Warner), extended over a number of years, has occasioned the expenditure of a great amount of money for incidental expenses and counsel fees, and losses of various kinds, but recent decisions on the primary questions involved in that litigation, have been favorable to Debtor, and there is every reason to expect that there will be a substantial recovery by the Debtor's Trustee in the final stages of that litigation" (Plan top p. 4).

The District Court has authorized the Trustee to expend the money necessary to continue this litigation (July M. R. Para. 20, p. 32a; Oct. M. R. Para. IV, p. 72a).

The District Judge and the Circuit Court of Appeals both recognize the probability of recovery by Debtor in this action, the District Judge by providing that the proceeds should be distributed to creditors to the full amount of the claims and the balance to Debtor's present stockholders, which was affirmed by the Circuit Court of Appeals (132a, 133a, —).

(4) *The Master refused also to value Debtor's claim against Brynoldt*, the proof as to which is stated above, for

damages growing out of Brynoldt's claiming absolute title to its property, with no foundation for such claim, and thereby destroying such credit as Universal had after its long controversy with Stewart-Warner.

(5) *The Master refused to value a coupler patent,* the proof as to which was that, the goods manufactured under the patent would vary in value between $100,000 and $300,000 per year (Oct. M. R. Para. 4, p. 62a), making an average of $200,000 production on which at 3% would be $60,000 a year and for the twelve (12) years the patent runs would amount to $72,000, with a present value of $40,000 (Id. Para. 8, p. 64a). Brynoldt's entire claim was for $23,500 (Plan p. 49 to 54 inc.), and title to the patent was taken by him for the same consideration as that for the Bill of Sale which he exacted for Debtor's other property.

(6) *The Master refused to value Universal on earnings, the proof as to which was as follows:*

(a) Debtor's Prospects

The Master reported as follows,

> "there is a probability that in the future there will be a great and increasing need of lubricating devices such as are manufactured by debtor, and for similar equipment." (July M. R. Para. 13, p. 29a.)

Universal's profits in the future should be five and a half times as great as they have been in the past, owing to the fact that new machinery (which has been partly and will be wholly acquired), is that much more efficient. (Id., Para. 14, p. 30a; Oct. M. R., Para. 6, p. 63a.)

> "* * * the Trustee thinks that by buying one machine at a time and selling some of the old ones, a modern plant would be built up which would have a small but profitable production and be able to compete

with any competitor at any price." (July M. R., Para. 15, p. 30a.)

"The industrial business has recently been profitable, * * *," (Id., Para. 11, p. 28a).

"The evidence shows grounds for expecting success for the reorganized company if it has adequate working capital," (Id., Para. V, p. 50a).

"The prospects for the entire line of fittings including this coupler are a great deal brighter than they were at the time of the previous hearing," (Oct. M. R., Para. 4, p. 62a).

"In the Trustee's opinion, if there is a prompt reorganization and building up of the key personnel, the company will have profitable operations to such extent as to be able to maintain dividends on the preferred stock and possibly to pay it off over a period of years," (Id., Para. 7, pp. 63a, 64a).

Mr. B. F. Hunter, the Chief Lubrication Engineer of the Gulf Oil Corporation, testified that it is his opinion that the products manufactured by Universal will not only be greatly needed in the future, but will increase, largely in use and demand.

(b) The operation of the business by the Trustee has resulted as follows:

May to December 1941—Profit	$17,613.55
For year of 1942—loss	$55,930.47
For year of 1943—profit	$151,008.42
January 1 to May 31, 1944—profit	$83,934.22
(Id., Para. 8, p. 27a.)	
The profits for the full year of 1944 were	$124,046.56
Universal's net profits from May, 1941 to September, 1944, three and a third years, were	$196,625.72

At the rate per year of $60,000 (Oct. M. R. Discussion Para. 1, p. 68a).

(c) *Increased earnings will arise from modern, efficient equipment, which has been acquired recently to replace part of the obsolete and inefficient machines.*

"With one man's labor, 1,000 units per hour can be produced from one Davenport Automatic Screw machine, as compared with 180 per hour from one old machine," the new machine being five and a half times as efficient as the old one (Appendix, July M. R., Para. 14, p. 30a).

Universal acquired three of the new type machines previous to last October and 40% of the machinery is efficient (Oct. M. R. Para. 6, p. 63a).

Universal's property has rapidly increased in value.

"Universal's tangible assets—May 26, 1941, amounted on liquidation value to $39,192.35 and on going concern value to $76,470.59.

Universal at present—has a paid in invested capital for Federal Tax purposes of approximately $329,000.00 (Amended Plan p. 5). This large increase in assets has been without any substantial increase in liability (Schedule of Debts in Petition for Order declaring Universal a Bankrupt), showing assets of $63,909.16; showing debts of $331,661.18.

(d) Debtor's Cash Position

This position was as follows on the following dates, viz:

May 31, 1944	$118,478.21
Aug. 31, 1944	137,976.23
(Oct. M. R., Para. 10, p. 66a) (Trustee's Report)	
Dec. 31, 1944	201,330.67
December Inventory	59,133.85
Total current assets	260,464.52

The July Report (Para. 38), showed cash requirements of the Plan $58,803.53.

This consists of the following payments:

To Brynoldt	$35,000.00
Clark & Doolittle Judgment	5,803.53
On Federal Taxes	10,000.00
Pennsylvania Taxes, disputed	8,000.00
(July M. R., Para. 44a)	$58,603.53
Deducting from	$201,330.67
the above	58,603.53
Leaves	$142,727.14
Deducting from	$260,464.52
the above	58,603.53
Leaves	$201,860.99

The Total Federal Tax is $27,351.33, the balance of which after payment of $10,000., is $17,351.33, and is to be paid in 12 equal monthly payments, commencing the first month after consummation of the Plan (July M. R., Para. 38, pp. 90, 91).

The Debtor needs as cash capital, only $75,000.00, and has current assets, as shown above, of $201,860.99, if we omit as we should the $35,000 for Brynoldt, the current assets are $236,860.99.

(e) "*Solvency as Estimated by Master.*"

Claims not disputed by Trustee amount to	$397,927.61
Physical property (not including Stewart-Warner claim or patents)	327,000.00
Excess of debts over value of physical assets	$70,927.61

"Solvency as Correctly Estimated on part of Tangible Assets Only."

(Para. II, p. 69a) Physical Property valued at	$327,000.00
(July M. R., Para. 5) Patents	40,000.00

Mistaken calculation of value of tangible assets thru allowing ¾th of the difference, (instead of ½), between the two equally reliable appraisals, to the Trustee and creditors	$23,839.84
Total	$390,839.84
Claims not disputed by Trustee	$397,927.61
Excess of liabilities over tangible assets (not including claims against Stewart-Warner and Brynoldt)	$7,087.77
There is included in the Master's claims, the Brynoldt invalid rental claim (which should be deducted), of	$29,316.00
This leaves an excess of assets (not including claims), over liabilities, of	$22,228.23

The conclusions and decisions by the Master, District Judge and the Circuit Court of Appeals were as follows:

The Master found that Universal is insolvent and approved the Plan, whereby the only possible benefit to be derived by the present stockholders is the right of the present preferred stockholders to purchase at $10.00 per share one share of common stock of the reorganized company for each share of their present preferred stock, and the right of the common stockholders to purchase at $10.00 per share one share of common stock of the reorganized company for ten (10) shares of their present common capital stock (Plan 20, 21).

The present company has outstanding 35,000 shares of common stock of the par value of $1.00 per share, and 2150 shares of preferred stock of the par value of $100. per share (Id., p. 5).

The reorganized company would have 4,000 shares of preferred stock of no par value and 15,000 shares of common stock of no par value (Id., p. 11).

Aside from these rights of the present stockholders, the stock of the new company would be distributed as follows: unsecured general creditors would receive one share of preferred stock for each $100 of their claims, plus one share of common stock (Id., p. 20); the remaining shares may be sold by the reorganized company (Id., p. 12).

The present company has two and a half times as many shares as the reorganized company, and as the present stock is worth $1.00, the new stock would be worth $2.50, except for the fact that there are only 2,150 preferred shares in the present company and there would be 4,000 in the new company, and the new stock is to be redeemed at $100. per share (Plan, p. 12). So, the liens ahead of the common stock in the new company will be approximately twice those now existing, and the right to purchase, at $10.00, common stock worth no more really than the present $1.00 common stock, has no possible value.

The secured claim of Clark & Doolittle is to be paid (Id. p. 19).

Brynoldt is to receive $35,000 for satisfactions of his mortgages and judgments and withdrawal of his Reclamation Petition, his rights in escrow funds, or for royalties as to the coupler or other patent, and an assignment to the reorganized company of any interest in the machinery in Debtor's plant or in the patents, and for the difference between the face of his claim and $35,000.00 (M.R. 23 a), he is to receive the same treatment as other unsecured creditors, subject to the condition that Brynoldt allow three (3) claims, *viz*, a judgment for $2,960.69 recovered by W. S. Haggott (M. R. 22a), and two mortgages, one for $5,580.54 and the other for $2,260.50 (M. R. 23a, 24a), to remain unpaid not more than a year after consummation of the Plan.

The reorganized company is to have seven (7) Directors, including Austin L. Staley, the present Trustee (whose

brother is the husband of a daughter of Brynoldt), Christian Brynoldt, and Henry Bergstrom, his attorney (Plan p. 14).

There is only a remote possibility that Brynoldt could sustain his claim of absolute ownership of the Debtor's property, the Trustee asserts (M. R. bot. p. 34a).

The Master specifically allowed $29,316, the amount Brynoldt claimed for rental by Debtor for its own property (Bot. M. R. 22a).

The Master also allowed Brynoldt his alleged loans from April 27, 1936, to April 11, 1938, $13,568.25 (Id. 21a, 22a), but his Reclamation Petition was filed November 24 1937, and stated that Debtor's entire indebtedness to him exceeded $20,000 (Plan p. 50), thus covering the period from April 27, 1936, to November 24, 1937, a year and seven months of the two years for which the $13,568.25 was claimed.

The original Plan provided that the present preferred stockholders should receive one share of common stock in the reorganized company for each share of their present stock and the holders of the present common stock should receive common stock in the reorganized company at the rate of one share of new stock for ten shares of the present stock (pp. 18, 19). As stated hereinabove, on account of the increase from the 3,500 common shares to 15,000 in the reorganized company, and of the increase of preferred stock from 2,150 to 4,000, this provision for the present stockholders had at most only a nominal value, yet the Master, of his own motion and without objection on the part of any creditor, held that the Plan was not fair or equitable because of this nominal provision for present stockholders (App. 57a).

The District Judge affirmed the October report of the Master with the following exception, *viz*,—he directed that the proceeds of the Stewart-Warner litigation be paid

to the reorganized company to the amount needed to retire its preferred stock—the balance, if any, to be distributed among Debtor's preferred and common shareholders (App. 132a, 133a).

B. Reasons Relied On for the Allowance of the Writ

Your Petitioner contends that the writ should be granted for the following reasons:

1. The refusal to value the Debtor Corporation on earnings is in conflict with the applicable decisions of this Court.

2. The refusal to value the Brynoldt claim is in conflict with the applicable decisions of this Court.

3. The refusal to value the coupler patent is in conflict with the applicable decisions of this Court.

4. The allowance of Brynoldt's claim of $29,316 for rental by Universal so far departs from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision.

5. The refusal to permit the Debtor to seek recovery of the damages suffered by it through Brynoldt's unfounded claim of title and consequent injury to its credit so far departs from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision.

6. The refusal to value the Stewart-Warner claim is in conflict with the applicable decisions of this Court.

7. The provision of the Plan whereby the Debtor's creditors are to be paid in full from the profits of the Stewart-Warner litigation and are, in addition to payment in full, to be presented as a gift with all Debtor's property (other than the balance of the proceeds of the Stewart-

Warner litigation remaining after payment of the creditors in full), worth at least $327,000, aside from the Stewart-Warner and Brynoldt's claims, and the coupler patent, so far departs from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision.

8. The Master's holdings that three-fourths of the difference between two equally reliable appraisals of tangible assets should be given to the Trustee and the creditors, his refusal to value the Stewart-Warner and the Brynoldt claims, and to allow suit to enforce Universal's claim against Brynoldt, his striking out of his own motion and without objection by any creditor of the merely nominal provision for the present stockholders contained in the original Plan, the approval of Brynoldt, his attorney and the brother of his son-in-law as three of the Directors of the reorganized company and the provision for payment to Brynoldt of $35,000 cash, this payment to Brynoldt being the only cash payment to an unsecured creditor, and the approval of all these rulings made by the Master's two reports, by the District Judge and by the Court below constitutes in the aggregate a disposition of this proceeding which so far departs from the accepted and usual procedure as to call for an exercise of this Court's power of supervision.

9. The provisions in the plan for the selection of Brynoldt, his attorney, and Staley, the brother of his son-in-law, as Directors of the reorganized company, is not an equitable one and is incompatible with the interests of the present stockholders of Universal, and especially with the preservation of their rights in the claim of Universal against the Stewart-Warner Corporation, and such a provision is in conflict with Title 11, Section 616 of the U. S. Code.

10. The plan is neither fair nor equitable in that—

(a) It fails to provide for determining the question of solvency by valuing Universal on earnings;

(b) It fails to value the Stewart-Warner claim, the Brynoldt claim and the coupler patent;

(c) It allows the invalid Brynoldt rental claim of $29,316.00;

(d) It provides, in the eventuality described in the plan, for the payment to the creditors in full and for presenting them as a gift, the Universal's property (other than the proceeds of the Stewart-Warner claim), worth approximately $400,000; and

(e) It provides for making Brynoldt, his attorney, and the Trustee, the brother of his son-in-law, directors, and prefers Brynoldt's invalid claim for a large payment, that being the only cash payment to an unsecured creditor.

11. It is urged that there should be a reversal of the decree below in the public interest: that the enforcement of the anti-monopoly statutes is of vital importance and it would be greatly hindered if it were established, as the decree below would, that if a citizen thru long, vigorous and single-handed effort breaks a monopoly, but in doing it becomes unable to pay his debts at once, but has his business and his claim against the monopolist for damages inflicted, all that he has, except what remains of these damages after paying the creditors in full, will be taken from him and given as a present to his creditors in addition to their being paid in full.

The writ should be granted, therefore, because there is involved this public and general and highly important interest, and failure of the Court below to recognize and give appropriate weight to the great public interest involved, so far departs from the accepted and usual course of judi-

cial procedure as to call for an exercise of this Court's power of supervision.

All of which is respectfully submitted.

WHEREFORE, your Petitioner respectfully prays that a writ of certiorari be issued under the Seal of this Honorable Court, directed to the Circuit Court of Appeals for the Third Circuit, commanding that Court to certify and to send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings of the case, numbered and entitled on its docket, No. 8902, in the Matter of Universal Lubricating Systems, Inc., in Proceedings for Reorganization of a corporation under Chapter X of the Bankruptcy Act, and that said judgment of the said U. S. Circuit Court of Appeals for the Third Circuit may be reviewed by this Honorable Court, and that your Petitioner may have such other and further relief in the premises as this Court may deem proper.

STOCKHOLDERS' COMMITTEE,
By S. WALLACE DEMPSEY,
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Washington, D. C.

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Pittsburgh, Pa.

Dated: August 22, 1945.

BRIEF IN SUPPORT OF PETITION

This is an application for a writ of certiorari for a review of the decree of the United States Circuit Court of Appeals for the Third Circuit, affirming a decree of the United States District Court for the Western District of Pennsylvania, approving a plan for the reorganization of a bankrupt.

The material facts and questions involved are set forth in the foregoing Petition.

The questions for decision are:

(1) Whether (as the Committee-Appellant contends), Universal's property should have been valued on earnings, and the refusal to so value was error requiring reversal,

(a) "The basic question in valuation in reorganized purposes is how much the enterprise in all probability can earn" (*Fed. Power Com.* v. *Hope Nat'l Gas Co.*, 320 U. S. 591, 602, Note 9). *Citing Group of Institution Investors* v. *C. M. St. P. & P. R. R. Co.*, 318 U. S. 523).

(a) No exception is made by this Court to its requirement that the valuation be on earnings, since, if left to the discretion of the Lower Court, the requirement would be abrogated:—The Lower Court would overrule this Court on a question as to which this Court is most insistent,—such a result would be revolutionary.

(b) Here, not alone, is there no adequate reason for refusal to value on earnings, but there are most compelling reasons for so valuing.

A valuation on earnings is based on the Debtor's prospects, and in refusing to value on earnings here the Court

overrules a most accomplished and experienced witness, the Chief Engineer of the Gulf Oil Corporation, the Master and the Trustee on a business,—not a legal,—question, since they all contend that the prospects of the corporation are most promising. Yet the knowledge of the Court below was far less than that of the witness, the Master and the Trustee.

One of the two grounds for refusal to value on earnings,—viz., that the future market will be less than that created "under the highly artificial stimulus of war production", was conclusively shown baseless.

The only other ground is that "an unusually favorable tax situation" existed in 1944 and is answered by the fact that Congress is now preparing and will doubtless pass a tax bill which will permit small business to earn a fair profit.

The tax credit for 1944 was about $70,000 and as the earnings were over $150,000, a net profit of over $80,000 would have remained if the tax had been required to be paid, and as the debts amount to only $400,000 and the dividends at

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NOTE I. "The commercial value of property consists in the expectancy of income from it. Such criterion is the one here, since we are dealing with the issue of solvency arising in connection with reorganization plans involving productive properties. It is plain that valuations for other purposes are not relevant to or helpful in a determination of that issue, except as they may indirectly bear on earning capacity. The criterion of earning capacity is the essential one." *Consolidated Rock Co.* v. *Dubois*, 312 U. S. 510, 526.

"The Supreme Court has several times said that the best test of the value of a going commercial enterprise is its earning capacity." *Galveston H. & S. R. Co.* v. *Texas*, 210 U. S. 217, 226; *Consolidated Rock Products Co.* v. *Dubois*, 312 U. S. 510, 525, 526; *Group of Institutional Investors* v. *Chicago M. St. P. & P. R. Co.*, 318 U. S. 523, 540; *Dudley* v. *Mealey*, 147 F. 2d 268.

"That this earning capacity was something in addition to the value of the tangible property sought to be taken." *Puget Sound Power & Light Co.* v. *City of Puyallup*, 51 F. 2d 688. 51 F. 2d 694.

"A sum of values based on physical factors and assigned to separate units of the property without regard to the earning capacity of the whole enterprise is plainly inadequate (*Consolidated Rock Co.* v. *Dubois*, 312 U. S. 510, 526)."

6% would amount to only $24,000, the profit remaining would not alone have paid these dividends in full, but have left approximately $60,000 to redeem preferred stock or be paid to the common stockholders.

The witness, the Master and the Trustee all knew and must have given due weight to war demand and taxes, yet they agreed that the Corporation's prospects are most promising. *This Court had no new facts on which to base refusal.*

The Court below erred in seeking to cast doubt on the showing that the Trustee has already largely replaced and will completely replace obsolete machines with new ones which will produce, with no added expense, 5½ times the production of the outmoded and antiquated machines, but the proof was clear and from it the conclusion is inevitable that previous earnings will be greatly increased in the future.

The Court below states that the Corporation lost money from 1932 to 1941, in every year but one, and says that the Special Master stated that the losses may have been due to litigation with Stewart-Warner, though he did not so find. It is stated in the Plan itself that,

"That litigation extending over a number of years has occasioned the expenditure of a great amount of money" (Plan p. 4), "and Kalish, the attorney, states that the Debtor lost $2,000,000 through Stewart-Warner's unfair competition" (App. 125a, 130a). So the loss from 1932 to 1941 would have been a profit but for this unfair competition and is not a recurring loss or one due to the business. This allegation and admission is nowhere disputed and is conclusive (3 Jones on Evidence, 2d Ed. § 1005, p. 1847). The Company earned $151,008.42 in 1943, and $124,046.56 in 1944, and figuring the $2,000,000 lost through unfair competition as profit for the nine (9) years from 1932 to

1941 would make an average profit of over $200,000 per year.

The failure to value on the earnings constitutes a highly material error, because at the earned rate of $150,000 a year (and not taking into account the greatly increased earnings which will come from new machinery), Debtor's business would be worth $1,650,000 using 11 times the net earnings as a yardstick. (*Puget Sound Power & Light Company* v. *Puyallup*, 51 F. (2) 688, 694).

(2) The reasons hereinabove stated for granting a writ as Nos. 2, 3 & 6, being for refusal to value the Debtor's claim against Brynoldt or the coupler or the claim against Stewart-Warner, will be combined as to the general law, applicable to all of them, and the special arguments applicable to each of them will be stated separately.

The Court Below simply "extinguished" these three claims by refusing to give them any value.

Any difficulty or uncertainty as to the value of the Stewart-Warner and the Brynoldt claims is no excuse for failure to value them, and there is no difficulty or uncertainty as to the value of the coupler patent. "Consolidated makes some point of the difficulty and expense of determining the extent of its liability * * *. The fact that the claim might be settled, with the approval of the Court, after full disclosure and notice to interested parties, does not justify the concealed compromise effected here through the simple expedient of extinguishing the claim" (as is done to Stewart-Warner, the patent claim and the Brynoldt claim). *Consolidated Rock Co.* v. *Dubois*, 312, U. S. 510, 522, 523.

A

There are the following special reasons why the Stewart-Warner claim should have been valued and why it was error to refuse to value it,—

(1) The Trustee states in the Plan,

> "That litigation extended over a number of years has occasioned the expenditure of a great amount of money * * * but recent decisions have been favorable to Debtor and there is every reason to expect that there will be a substantial recovery by the Debtor's Trustee * * *" (Plan, top p. 4).

The Plan, the Trustee's pleading and the allegation quoted is conclusive evidence that Debtor will make "a substantial recovery". (Jones on Evidence, 2nd ed. sec. 1005, p. 1847).

(2) The District Court has authorized the Trustee to continue this litigation (July M.R. Para. 20, p. 32 a; Oct. M.R. Para. IV, p. 72 a), and holding that this claim is so valuable that the stockholders' money must be expended to litigate it, is a conclusive answer to a holding that it has no value in determining solvency.

(3) The attorney in this case states that he can prove liability "up to the hilt" (127 a), and that the Debtor lost $2,000,000 (125 a, 126 a, 130 a) through unfair competition. There is no evidence to the contrary. So, on the proof Debtor is entitled to recover $2,000,000 and the presumption in equity is that it will recover the amount due it (30 C.J.S. sec. 104 p. 506); and as the Stewart-Warner acts were wrongful, only the best proof available will be required (*Eastman Co.* v. *So. P. Co.*, 273 U. S. 359).

Both the District Court of the Circuit Court of Appeals recognize the strong probability, if not certainty, that there will be "a substantial recovery" by providing how the amount of it will be distributed.

B

The claim against Brynoldt for the damages arising from baseless assertion of title was a clear one and the refusal to value it was error.

The Court below mistakenly held that this claim for slander of title arose from the Reclamation Petition filed after Debtor had been declared a bankrupt, and that Brynoldt had the right to assert title in that, whereas the baseless claim of title was in exacting a Bill of Sale and a lease simultaneously, and thereby for a long period claiming title to all of the Debtor's property and necessarily ruining what credit it had left after its ruinous litigation with Stewart-Warner.

"The Trustee believes that there is but remote possibility that Brynoldt could sustain his claim to absolute ownership (July M.R. Para. 25, p. 34 a)."

This is a conclusive admission that Brynoldt's claim of title was baseless. (Jones on Evidence, 3rd edition, Sec. 272, p. 405). Moreover, Universal was encumbered with debt and equity will relieve on account of the advantage taken and hardship inflicted (*U. S.* v. *Bethlehem Steel*, 315 U. S. 328, 329).

This baseless claim by Brynoldt was prejudicial in a pecuniary sense to Debtor, who was engaged in trade and, therefore, constituted actionable libel (*Pollard* v. *Lyon*, 91 U. S. 308, 310).

As Brynoldt required an absolute Bill of Sale for the loan of money, which was calculated to invite and result in fraud and injustice this act constituted a quasi-fraud (Waite on Fraudulent Conveyances and Creditors Bills, 3 ed. sec. 404, p. 736), and as the slander of title was gross, deliberate and wilful, and a reckless disregard of Debtor's rights, Universal is entitled to exemplary damages (37 C.J.S. sec. 144, p. 489).

C

As appears last above under B. Brynoldt's claim to title of the coupler patent was baseless and Debtor remains as against him the owner of the patent. Its value was

proved by the Trustee to be $40,000 and it was plain error to refuse to value it at that sum, and the error was vital on the question of solvency because of the very slight excess claimed to exist of liabilities over assets. (Oct. M.R. Para. 4, p. 62 a; Para. 8, p. 64 a).

D

The allowance of Brynoldt's claim of $29,316 for rental of the Debtor's property so far departs from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision.

Under "B" above, we have shown that Brynoldt had no title to Debtor's property, in that his attempt to secure $327,000 worth of property for $20,000 was so unconscionable that equity will relieve from the Bill of Sale (*U. S.* v. *Bethlehem Steel*, 315 U. S. 328); Brynoldt then had no title to the property he sought to give a lease of,—he simply attempted to lease Debtor what remained and always was its own property. There was, therefore, no foundation whatever for the allowance by the Master, the District Judge and the Court Below of $29,316 for rental, and with the issue concededly close as to solvence, the error was vital.

More than that, the allowance of this rental certainly does so far depart from the accepted and usual course of judicial procedure and from fair and just treatment as to call for this Court's power of supervision, and to have it stamp this transaction, as it is, unconscionable.

E

For the reasons stated in the Argument as to the refusal to value the Brynoldt claim and on the allowance of the Brynoldt claim for rental, the refusal to permit a suit to be brought against Brynoldt for recovery of the

damages through his unfounded and prolonged claim of title, and the resulting injury to the Debtor's credit so far departs from the accepted and usual judicial procedure as to call for this Court's supervision.

F

The provision in the Plan whereby the creditors receive all the stock of the reorganized company, except what, if any, may be sold, and that the proceeds of the Stewart-Warner suit shall be used to pay, if sufficient, the Preferred shares of the reorganized company in full will result, if sufficient money is realized from the Stewart-Warner suit to pay these Preferred creditors in full, in their being so paid in full, and in their being made a present and a gift of all the Debtor's other property, concededly worth $327,000 (aside from the Stewart-Warner claim, the coupler patent and the Brynoldt claim), which is flagrantly unjust, and the power to make such a gift goes beyond the jurisdiction of the Courts Below. This is so serious and vital an error as to alone clearly call for the exercise of this Court's power of supervision.

G

The eighth reason for certiorari is that the rulings of the Master in his two reports, approved by the District Judge and the Circuit Court of Appeals, in the aggregate constituted such departure from accepted and usual course of judicial procedure as to call for this Court's power of supervision. This is made plain by the fact that the real issue is whether Universal is solvent and whether the correct determination of any of the questions specified would have not necessitated a ruling that the corporation is solvent.

(1) The decision below is in direct conflict with the repeated holdings of this Court that valuation must be on

earnings. Not alone is there no excuse for the refusal to value on earnings, but facts produced required such a valuation. If the rule of this Court is to be observed, the decision of the court below must be reversed.

(a) In nine years debtor lost, thru unfair competition, $2,000,000, over $200,000 a year, a non-recurrent loss not due to the business, but for which there would have been a corresponding profit.

(b) During the 3½ years of the Trusteeship the earnings have averaged $60,000 a year, two and a half times the amount needed for dividends to the creditors.

(c) For the last two years the earnings have averaged $135,000 a year, over five times what will be needed for dividends.

(d) In three and a half years part of debtor's tangible assets have grown from $63,909.16 to $327,000, an increase of about $263,091, and it would take at the present rate of earning about 5 years to pay the creditors their claims of $397,000.

(e) The best qualified witnesses procurable, the Master and the Trustee, asserted that the outlook of debtor is most promising. There is no evidence to the contrary.

(2) If the rule pronounced by this Court, that all a debtor's property must be valued in determining solvency is to be observed, the decision below must be reversed. In conflict with this rule, the Court below extinguished three big, substantial claims.

(a) Debtor lost $2,000,000 thru unfair competition by Stewart-Warner. Liability can be proved up to the hilt. The litigation has been carried on many years, at large expense to the stockholders. Both courts below recognize

its value by providing for distribution of its proceeds. Yet, the court below refused to value it.

(b) The patent has a proved present value of $40,000, yet the Court below refused to value it.

(c) The Brynoldt rental claim of $29,316 is glaringly, indisputably so invalid that the Trustee admits that there is but remote possibility of Brynoldt establishing the absolute ownership necessary to make the claim valid, yet the court below held this wholly bad claim valid.

(d) It is obvious that debtor must have been severely damaged and handicapped by Brynoldt's prolonged and baseless claim of title, and that the damages must have been large, yet the court below refused to value it.

(e) Making Brynoldt the favorite of the reorganization by giving him three directors, and him alone of the unsecured creditors, a large cash payment, is unfair, inequitable and prejudicial to the stockholders.

II

Lastly, it is urged that this litigation has a public interest which should influence the decision of all of the issues involved in it, in that the enforcement of the anti-monopoly statutes is of vital importance to the Country, and it would be clearly hindered if the decree below were affirmed, for that would be noted to all manufacturers that, if anyone of them single-handedly and courageously fought a monopoly to a successful result, but in doing it became unable to pay their debts at once, although he had his business and a claim against the monopolist for large damages, all that he has remaining, except what remains of these damages after paying his creditors in full, will be taken from him and made a gift to his creditors in addition to their being

paid in full. Such a prospect would certainly deter any careful or thoughtful man from striving to enforce the right of all citizens to competition and would result in his acquiescing in what is recognized as one of the real ills and dangers of the capitalistic system.

STOCKHOLDERS' COMMITTEE,
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Attorney,
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Attorney,
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Dated: August 22, 1945.

SEP 11 1945
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

NO. 359.

STOCKHOLDERS' COMMITTEE OF THE UNIVERSAL LUBRICATING SYSTEMS, INC., Petitioner,

v.

AUSTIN L. STALEY, Trustee in Reorganization for the Universal Lubricating Systems, Inc.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

BRIEF FOR AUSTIN L. STALEY, TRUSTEE IN REORGANIZATION FOR THE UNIVERSAL LUBRICATING SYSTEMS, INC., IN OPPOSITION.

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SUBJECT INDEX.

	PAGE
Opinion Below	1
Jurisdiction	1
Question Presented	2
Statute Involved	2
Statement	2
Argument	8
Conclusion	15

CITATIONS.

CASES:

Committee for Holders, etc. v. Kent, 143 F. 2d 684 (C.C.A. 4, 1944) 12

Consolidated Rock Products Co. v. DuBois, 312 U. S. 510, 563 15

Drexel v. Loomis, 35 F. 2d 800 (8th Cir., 1929) ... 15

Gordan v. H. S. Co., 319 Pa. 174, 179 15

Fred D. Jones Co., 268 Fed. 818 (7th Cir.) 10

Mitchell v. Investment Securities Corp., 67 F. 2d 669 (5th Cir.) 10

Stewart-Warner Corp. v. Staley, 42 Fed. Supp. 140 (1941) 11

Universal Lubricating Systems, Inc., 59 Fed. Supp. 171 1

STATUTES:

Bankruptcy Act, as amended by the Act of June 22, 1938, c. 575, sec. 1, 52 Stat. 840:

U. S. Code, Title 11, Sec. 48 14

U. S. Code, Title 28, Sec. 347 1

U. S. Code, Title 11, Sec. 574 2

Sections 169 and 174 of the Act, U. S. Code, Title 11, Sec. 569, 574 4

MISCELLANEOUS:

Columbia Law Review, 582, 597, 598 10

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Opinion Below.

The Opinion of the Circuit Court of Appeals for the Third Circuit has not been reported as yet; the District Court Opinion is reported at 59 Fed. Supp. 171.

Jurisdiction.

Petitioners apparently are proceeding under Section 347 of Title 28, U. S. Code.

Question Presented.

1. Is the amended Reorganization Plan of the Trustee for the Universal Lubricating Systems, Inc., fair, equitable and feasible, and such as should be approved?*

Statute Involved.

U. S. C., Title 11, Sec. 574.

Statement.

We regret to say that the summary statement** of the matters involved as set forth in the petition (page 2 *et seq.*) contains so many errors of fact as to make it necessary that we hereby file our own statement thereof.

In this case, on June 27, 1945, the Circuit Court of Appeals for the Third Circuit, following appeal of the petitioner here (appellant in that Court) entered an Order affirming the Order of the District Court of the United States for the Western District of Pennsylvania which approved the Trustee's amended Plan of Reorganization for the Debtor company, as fair, equitable and feasible under U. S. C., Title 11, Sec. 574; it is that Order of the Circuit Court of Appeals for the Third Circuit, apparently, that the Petitioner herein hereby now is attempting to have reviewed in the Supreme Court.

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* U. S. C., Title 11, Section 574.

** In general the facts were found against the contentions of petitioner-committee, by the Special Master (pages 19R *et seq.*). Thereafter the petitioner-committee was driven to citing its own contentions as to what the facts were and to ignoring, generally, those Findings.

Other material facts are, as follows:

Universal Lubricating Systems, Inc., debtor herein, has been engaged in the manufacture of lubricating devices since 1932, its place of business being in Oakmont Borough, Pennsylvania. That Borough is a suburb of Pittsburgh. The debtor company lost money in every year except one from 1932 to 1941.* In 1941, its plant was in the hands of the Sheriff by reason of a writ of execution issued by a creditor, and thereupon a bankruptcy petition was filed against it, resulting in an adjudication in bankruptcy in this proceeding; that bankruptcy proceeding subsequently was translated by debtor's petition into a reorganization proceeding under Section X of the Bankruptcy Act (see discussion in Special Master's Report on Plan, page 50R, also, First Finding of Fact, 19R *et seq.*). Austin L. Staley has been and is its Trustee in said proceeding, and is the respondent herein.

In the reorganization proceeding, the Trustee has had considerable business success and has accumulated some cash, and has kept all of his current obligations paid, after, however, many troubles during the first few months of his operation (testimony page 114R, Supplemental Report of Special Master, 66R *et seq.*).

In the language of counsel for the petitioner-committee, the Trustee "has done a wonderful job"** (102R, fifth line from bottom).

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* 27R.

** During the war years, approximately two-thirds of the business of the Trustee has been the manufacturing of munitions for the National War effort; for instance, in 1943, the Trustee did about $225,000.00 worth of industrial business, and $497,000.00 worth of Government business. See 28R.

In the proceeding, on April 17, 1944, the Trustee filed a Plan of Reorganization of the debtor company, which was referred to Watson B. Adair, Referee in Bankruptcy, as Special Master to hold hearings under Sections 169 and 174 of the Bankruptcy Act, U.S.C.A. Title 11, Sections 569, 574. To this Plan, the Trustee later proposed amendments, which were likewise referred to the Special Master for hearing and report.

That Plan was fought by the petitioner-committee (18R) and after the Special Master had filed a report refusing approval of the Plan because he believed there could be no provision for stockholders (55R), the Trustee then, on September 18, 1944, filed an Amended Plan, copy of which has been attached to the record in the Circuit Court of Appeals and the main provisions of which are, as follows:

(1) That creditors of debtor shall be given one share of preferred stock, and one share of common stock in the reorganized corporation for each $100.00 of claims duly proven by them;

(2) The present common stockholders shall be given one share of the new common stock, upon paying $10.00 for each unit of ten shares of the old common stock;

(3) The present preferred stockholders shall be given one share of common stock upon paying $10.00 for each share of old preferred stock;

(4) That each share of preferred stock in the new corporation is to have ten votes, while each share of the new common stock shall have one vote;

(5) That the Stewart-Warner litigation shall not be passed to the reorganized corporation, but shall be retained and litigated by the Trustee, and

that the net proceeds of the litigation shall be earmarked for retirement of the new preferred stock.

Certain clerical amendments subsequently were made to the Plan, and, after further objections by the Committee, the District Judge filed his Opinion (13R) and entered an Approval Order (132R), which is dated March 12, 1945. By that Order, the District Judge affirmed the finding of insolvency and affirmed the findings and conclusions of the Special Master, with one exception; that one exception was that he directed that paragraph IX(c) of the Plan (12R) be deleted, and in lieu thereof that the Trustee substitute a new IX(c). That new sub-paragraph appears at page 18 of the Plan, joined to the end of the Circuit Court of Appeals Record. The effect of this substitution and change in the Plan, in substance, was that whereas the excess, if any, of the proceeds of the Stewart-Warner litigation after the payment of debts (the debts being represented in the reorganized company by new preferred stock) under the original* form of the Plan would go to the reorganized company, under the change and substitution, that excess will now go to the present stockholders of debtor. From said Order of Approval, of the District Judge, the appeal was then taken to the Circuit Court of Appeals for the Third Circuit by this Committee.**

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* 12R.

** Certain creditor interests also appealed from said Order on the ground that no provision for stockholders should have been made, and that appeal likewise was unsuccessful (see Opinion of the Circuit Court of Appeals), said creditors' appeal and the appeal of the petitioner having been covered by the said Circuit Court Opinion.

It is difficult for us to follow the summary statement contained in the petition for the reason that, generally, no page references are furnished—frequently that is because no page reference could be furnished by petitioner, in the circumstances; some of the facts set forth in that statement of petitioner are purely imaginary, or otherwise are completely outside of the record.

For example, there is not the faintest possibility of excuse for the statement "Brynoldt's entire claim was for $23,500.00," appearing at page 5 of the petition. It is true that he asserted the one claim for approximately that amount, but his other claims are set forth in close detail in this record,* and we can only believe that the petitioner in the sentence above quoted has been guilty of a deliberate misstatement of fact. The testimony with regard to Brynoldt's claims has not been printed or made a matter of record in the Circuit. No one ever requested that it be printed; the Order of the Circuit Court of Appeals, being the Order of April 19, 1945, with regard to the printing was as follows: (Page 1R)

> "AND NOW, to wit, this 19th day of April, 1945, upon the motion of A. E. Kountz, Esquire, attorney for Austin L. Staley, Trustee in Reorganization for Universal Lubricating Systems, Inc., and upon the stipulation of counsel for both the appellant and the appellee, it is
>
> ORDERED, that the argument in the above entitled cause be heard in the week of May 14, 1945, and, it is
>
> FURTHER ORDERED, that the parties may print in their appendix or appendices only the following

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* 21R *et seq.;* see Paragraph VI of Supplemental Report, 74R.

portions of the record in the court below: (1) the opinion of the court; (2) the plan of reorganization; (3) the Master's Report and (4) all testimony and exhibits relating to the chose in action asserted against Stewart-Warner Corporation.

FOR THE COURT,
BIGGS,
U. S. Circuit Judge."

Nor have the Order of the District Court directing the allowance and classification of claims (including the Brynoldt claim), nor the July 26, 1945, Order of Court (mentioned at page 13 of this brief, footnote), been made part of the Record in the Circuit Court of Appeals.

The Special Master has found that Brynoldt's claims amount to $71,011.35 (23R). No one has challenged those claims by testimony or otherwise controverted them in my intelligent way.

The Special Master, in findings 25, 26, 27 and 28 in his Report on the Plan, 24R, et seq., has set forth in close detail the nature of Brynoldt's securities; the Special Master has approved the provisions for Brynoldt in the Plan (see paragraph VI of the Special Master's Supplemental Report on the Plan, 74R). The Special Master's Report thereon has been approved and affirmed in the District Court and in the Circuit Court of Appeals.*

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* In our argument, we will also state that this present contention of petitioner's regarding Brynoldt's claim is moot and senseless (Page 13 *et seq.*)

Argument.

We do not pretend to be able to following the argument contained in the petitioner's brief.

One difficulty, of course, is that the facts sometimes are not as petitioner alleges them to be. The facts were found carefully and in detail by the Special Master (19R *et seq.*), and those findings were approved in the District Court and in the Circuit Court of Appeals.* Petitioner, in his brief, appears to desire to make but few references to those findings.**

I.

Petitioner's first argument is that the property of the debtor should have been valued on the basis of late earnings. The Circuit Court of Appeals, in its Opinion,

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* The opinion of the Circuit Court of Appeals will appear, we understand, at the back portion of the record, as filed in the Supreme Court by petitioner; but there has been an error on the part of petitioner's printer, apparently, as to the page number, so we are not undertaking to cite it by page number.

** An example of the garbled manner which the petition and brief of petitioner states the subjects is on page 18 of petitioner's brief. There, by the careless use of quotation marks, it is made to appear that the Trustee's Plan alleges a valuation of $2,000,000.00 for the Stewart-Warner law suit. Other gross errors to be found in the petition are—at page 3 thereof, a statement which the Trustee made with regard to Brynoldt's title to certain machinery and the weakness thereof has been tortured so as to imply that the Trustee believes that Brynoldt's title to the coupler patent is weak—quite a different subject. The statement "Brynoldt's entire claim was for $23,500.00", appearing at page 5 of the petition, of course, is a gross misstatement, as we have set forth more fully at page 6 and page 7 of this brief.

succinctly disposed of that argument on the part of the petitioner by the following:

"It is also made the subject of complaint that the valuation was not fixed by capitalization of earnings of the debtor. The debtor corporation has been in business since 1932 and up to 1941 lost money in every year but one. During management by the Trustee there was a profit in 1941, a loss in 1942 and large profits in 1943 and the first five months of 1944.

As to the years prior to the trusteeship, the special master stated that the losses may have been due to litigation with Stewart-Warner, though he did not so find as a fact. During the war years a portion of the business has been the manufacturing of goods for the national war effort for both Army and Navy. For instance, in 1943 the trustee did about $225,000 worth of industrial business and $497,000 Government business.* Due to a back log of losses which could be carried over, there was no Federal income tax payable in 1943. We heard a great deal of argument about good prospects for the business. The Court was told that with the installation of more modern machinery the productive capacity of a given machine would be increased; that as new machinery was added further increased production would be continuously possible. All of this may well be true and we hope, for the sake of those engaged in the enterprise, that it proves to be true. It bears upon the question of the feasibility of any plan which contemplates the continuance of the debtor as a going business concern. But such

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* See report of Special Master page, 28R *et seq.*

prospects do not furnish an argument for capitalization of earnings to show present worth when the earnings have come under the highly artificial stimulus of war production and an unusually favorable tax situation."*

(The comments in the first footnote here are our own.)

II.

With regard to the valuation of the Stewart-Warner lawsuit, we say—the Special Master, in his report (30R *et seq.*) sets forth the facts with reference to that pending law suit; and at page 48R of his report, the Special Master discusses in detail the rules of law with reference to evaluating a claim of that nature; we respectfully refer thereto. The opinion of the Circuit Court of Appeals also succinctly states this subject in that portion of its opinion which is set forth now in the footnote.**

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* A losing business generally is valued on a liquidating basis. See 29 *Columbia Law Review,* 582, 597, 598, *Mitchell v. Investment Securities Corp.* (5th Cir.) 67 F. 2d 669, *In re Fred D. Jones Company,* 268 Fed. 818 (7th Cir.). The liquidating value of debtor's physical assets (omitting a piece of land at Springdale which the Trustee sold for several thousand dollars and which is valued by the special master at $5,250) was $39,192.35 (see Special Master's report 25 a *et seq.*); the indebtedness of debtor is in excess of $400,000 (23 a).

** "The point most stressed by the appellants throughout their brief and oral argument has to do with a valuation for a claim against Stewart-Warner Company. The debtor makes lubricating apparatus and is a competitor of Stewart-Warner. It is stated that the debtor prevailed in certain patent litigation against that company. In October 1937 Stewart-Warner sued the debtor for the alleged infringement of certain patents. Debtor in November 1937 counter-claimed for damages for unfair competition and the counter-claim as amended in April

We feel that those references are ample.

The novelty of the petitioner's contention with regard to the valuation of said pending law suit is set forth clearly by the statement of the counsel for petitioner, before the special master, as follows: (79R)

"I don't say the full amount is less or more but I do say if he says he can prove liability it is exactly the same as having liability established."

1941 has been held to state a cause of action. 42 Fed. Supp 140 (1941). It is the failure to give a valuation to this claim against Stewart-Warner, as part of present value of the debtor, which is the shareholders' chief ground for complaint. The claim has not been ignored in the proposed rearrangements; the plan provides that the net proceeds of whatever is recovered in this lawsuit shall be used for the retirement of the new preferred stock, with any balance remaining to be distributed among the present preferred and common shares as a liquidating dividend.

The appellants say this claim should be valued for at least $750,000. They point to testimony from the attorney-at-law retained in the lawsuit against Stewart-Warner, that he estimated the damages suffered by the debtor from unfair competition at $2,000,000, that he expected to prove liability "up to the hilt". Then it is pointed out that equity will not suffer a wrong to be without a remedy, and, therefore, the presumption is that the full amount of loss will be recovered. Since, under the statute, damages are to be trebled, the $6,000,000 thus to be recovered will quite change the financial picture of the debtor.

We fear that the stockholders' committee has allowed itself to become overoptimistic in this argument. We have not, of course, the faintest notion of the strength of the debtor's case nor the defendant's de-

With the present stockholders of debtor thus obtaining under this Plan of the Trustee the full residue of the proceeds of the said litigation (if there should be proceeds) after the payment of expenses thereof and after the retirement of the debts of the debtor, it is difficult to find any moral or legal excuse for their attempts to fight the Plan.* The Special Master has set forth in detail the practical reasons why there must be an early reorganization, if there is to be any substantial hope for the commercial success of the reorganized debtor. (See Report of Special Master paragraphs 31, 32 and 33 page 38R *et seq.* and see supplemental report of Special Master at paragraph 9, 65R). At page 70R, the Special Master has found that "the prospects of successful operation of the business would be adversely affected by the prolongation of the trusteeship."

The Opinion of the Circuit Court of Appeals concurs in that finding, the language being "that the prospect of successful operation of the business would be adversely affected by prolongation of the trusteeship * * *" That finding of fact nowhere has been attacked, and could not be attacked.

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fense in the forthcoming litigation. The suit has not yet been tried and is still in the preliminary stage. Lawsuits, even those in which a plaintiff endeavors to prove liability up to the hilt, are uncertain things both as to the time which they take and what the end product to the litigant will be. We think there was no error in not including this claim in the evaluation of the debtor's property and that the provision made for the distribution of eventual net proceeds is both fair and feasible. We have examined the decisions cited to us. *The Committee for Holders, etc. v. Kent,* 143 F. (2d) 684 (C. C. A. 4, 1944). We do not find that the facts of that case give us any help in this one."

* See Paragraph IX c, Page 18 of the Plan.

III.

Petitioner's argument with regard to Brynoldt's $35,000.00 is senseless; that is so because of several details and circumstances.

As we believe that both the petitioner-committee and the Trustee-respondent properly could be criticized if they failed to inform this Court thereof, we respectfully call to the Court's attention that after the Circuit decision in the case at bar (exactly on July 26, 1945) the District Judge entered an Order* the effect

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* Following an application therefor and against the oral objections of counsel for petitioner herein, District Judge Gibson on July 26, 1945, in this proceeding, entered an Order directing payment, forthwith, and in advance of confirmation of the Plan, of certain secured and priority claims which had been unpaid for more than four years and which were clamoring for payment, and including the $35,000.00 Brynoldt item. The petitioner herein, by counsel, on July 30, 1945, notified the Trustee, respondent herein, that petitioner would take an appeal from the aforesaid Order, the notice being by letter in the following form:

"William C. McClure
Joseph M. McClure
Attorneys at Law
Pittsburgh, Pa.
7th Floor Jones Law Building
July 30, 1945

Kountz, Fry, Staley & Meyer
Attorneys at Law
544 Union Trust Building
Pittsburgh, Pa.

IN RE: Order of Judge Gibson, made July 26, 1945

Dear Sirs:

You are hereby notified that the Stockholders' Committee intends to appeal from that portion of the Order of Judge Gibson, made July 26, 1945, to-wit:

of which makes moot and academic the $35,000.00 Brynoldt subject.

However, we cannot refrain from commenting briefly on certain portions of petitioner's argument with regard to Brynoldt's claim. His claim, or claims, altogether amount to $71,011.35. See Page 23R *et seq.*, and Page 33R *et seq.* His securities are numerous mortgages and judgments on the real estate of the debtor, the title to the coupler patent, etc. The Special Master in paragraphs 26, 27 and 28 of his report on the Plan (35R *et seq.*) has set forth in close detail the nature of Brynoldt's securities; the Special Master, after reviewing the subject of the Brynoldt claim, has approved the Brynoldt cash compromise allowance at $35,000.00 (see page 74R,

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Subsection (b) of paragraph 1:

'To Christian Brynoldt, a secured and judgment creditor, in accordance with the provisions of paragraph 7(b) of said petition, the Trustee shall pay $35,000.00;'

You are, therefore, directed to withhold payment to Brynoldt pending the Appeal to the Circuit Court of Appeals of the U. S.

Very truly yours,
(s) W. C. McCLURE
of Attorneys
for Stockholders Committee"

WCM:bg

However, and notwithstanding the aforesaid letter, no such appeal was taken, and the time prescribed by law for such appeals has expired (Section 25 of the Bankruptcy Act as amended U.S.C. Title 11, Section 48.). Therefore, and in obedience to the aforesaid Order of Court the Trustee, respondent, at the time of the preparation of this brief, is now in the process of making payment to the said lien and priority claimants, including Brynoldt. A certified copy of said July 26, 1945, Order is attached to this Brief at the end thereof, with certificate showing also that no appeal therefrom has been filed.

paragraph VI of the supplemental report of the Special Master.)

The aforesaid approval by the Special Master of the Brynoldt allowance was not disturbed by the District Judge or by the Circuit. No creditor interest opposed it at any time.* Whether or not, under the facts that compromise allowance as to Brynoldt was a fair and reasonable one is a question of fact rather than of law. It is the policy of the Bankruptcy Court in reorganization cases to permit compromises at any stage of the proceeding, after notice, where justified. (See *Consolidated Rock Products Co. v. DuBois,* 312 U.S. 510, at page 563, *Drexel v. Loomis,* 8th Cir., 1929 35 Fed. 2nd 800, and the various bankruptcy and other cases cited or referred to in *Gordon v. H. S. Co.,* 319 Pa. 174, at page 179.)

Conclusion.

The Trustee, respondent, believes that it would be impossible for him within the confines of a simple brief to dwell upon the various errors and inconsistencies which are contained in the petition and brief of the petitioner; therefore, he will limit himself to the major items hereinabove set forth, and he respectfully submits that the petition is without merit in fact or in law and should be denied.

A. E. KOUNTZ, ESQ.,
CLARENCE A. FRY, ESQ.,
Attorneys for Austin L. Staley, Trustee for Universal Lubricating Systems, Inc., Debtor.

---

* 74R Par. VI.

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

In the Matter of
UNIVERSAL LUBRICATING SYSTEMS, INC.,
Debtor.

No. 21104 In Proceedings for Reorganization of a Corporation Under Chapter X of the Bankruptcy Act.

Order Upon the 10th Day of July, 1945, Petition for Order of Confirmation and Other Relief.

Filed July 26, 1945.

AND NOW, the 26th day of July, 1945, upon consideration of the Trustee's Petition filed the 10th day of July, 1945, praying for an Order of Confirmation of the Plan of Reorganization and for other relief, and which petition has come on for hearing this day, following ten (10) days' notice, by mail, to creditors and stockholders, as will more fully appear by affidavit of mailing filed the 24th day of July, 1945, and pursuant, also, to actual notice given to counsel for various parties in interest, as will more fully appear by affidavit thereof filed the 13th day of July, 1945, and it appearing to the Court that the Debtor has been decreed insolvent, and that the Trustee's Plan of Reorganization has been approved by a Judge of this Court and by the Circuit Court of Appeals for the Third Circuit, and testimony having been taken today which shows the acceptance of the Plan by the requisite amount of the general or unsecured creditors, they being the only class affected by the Plan, upon motion of A. E. Kountz, Attorney for Austin L. Staley, Trustee in Reorganization for the Universal Lubricating Systems, Inc., Debtor, IT IS ORDERED;

1. In accordance with sub-paragraph (c) of the Prayer of said petition, and in advance of the confirmation of the Plan, the Trustee is directed forthwith to pay certain secured claims and priority claims, upon surrender or satisfaction of the several items of security held by the secured creditors, respectively, as follows:

(a) To Clark and Doolittle, a secured and judgment creditor, in accordance with paragraph 7 (a) of said petition, the Trustee shall pay $5,680.29, plus interest, computed from the date of judgment to the date of payment;

(b) To Christian Brynoldt, a secured and judgment creditor, in accordance with the provisions of paragraph 7 (b) of said petition, the Trustee shall pay $35,000.00;

(c) To the Collector of Internal Revenue, as an anticipated and advance payment of the item of $10,000.00, which is payable upon confirmation of the Plan, in accordance with Exhibit "K" attached to the Plan of Reorganization, the Trustee forthwith shall make payment of $10,000.00;

(d) The Trustee shall pay, in cash, in full, or in such reduced amounts as he may be able to arrange through compromise, the Unemployment Compensation claims of the Commonwealth of Pennsylvania mentioned in paragraph 9 of the aforesaid petition.

3. Further hearing on the aforesaid petition filed the 10th day of July, 1945, is hereby continued and adjourned to the 28th day of August, 1945, at 10:00 o'clock A. M.

R. M. GIBSON,
D. J.

Certified from the records
this 7 day of September, 1945.
.....B. H. Berger.....Clerk

September 7, 1945.

I am unable to find from the records that an appeal has been taken in the above entitled case, since the date of the said order.

.....B. H. Berger.....Clerk

SEP 27 1945
CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1945.

No. 359.

STOCKHOLDERS' COMMITTEE OF THE UNIVERSAL LUBRICATING SYSTEMS, INC.,

Petitioner,

vs.

AUSTIN L. STALEY, Trustee in Reorganization for the Universal Lubricating Systems, Inc.

REPLY BRIEF.

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WILLIAM C. McCLURE,
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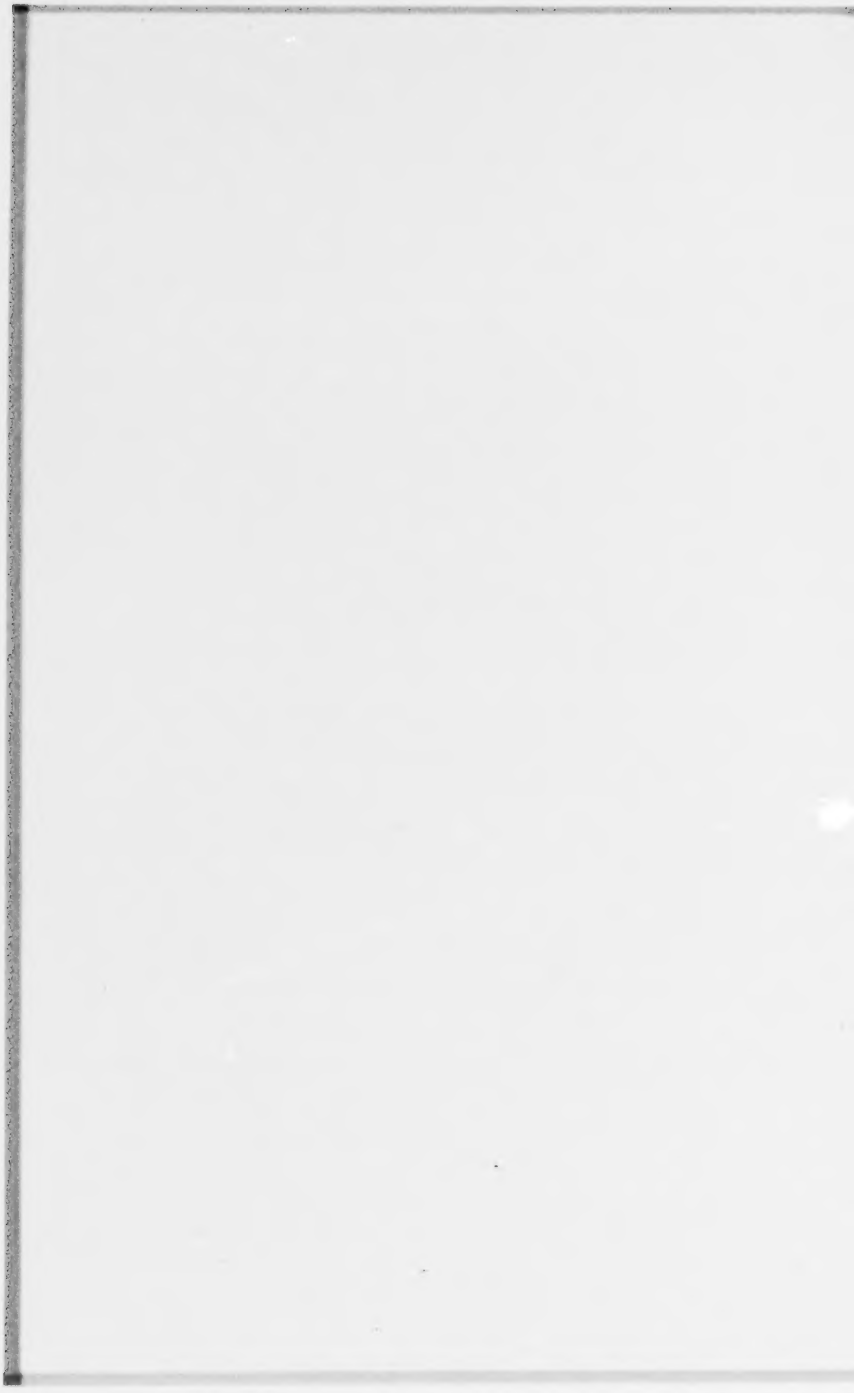

SUBJECT INDEX.

REPLY BRIEF.

Page

I.

The Master and the two courts below erred in refusing to value Universal on earnings. All the evidence required such a valuation 2

II.

It was a vital error to "extinguish" the Stewart-Warner claim and providing that the present stockholders own the claim subject to payment of Universal's debts is far from curing the damage, as the claim, through being "extinguished," became unavailable on the asset side to determine the real issue here,—that of solvency of Universal 6

III.

Debtor's claim against Christian Brynoldt for damages for slander of title is covered by the petition and original brief, and therefore will not be discussed here (Petition, p. 2; Orig. Brief, pp. 20, 21) 8

IV.

The court below approved the Plan, but made no separate finding as to the claim of Christian Brynoldt, which the Master allowed at $71,011.35. (App. 23a), a large part of which is clearly invalid.. 8

V.

All the facts as to Brynoldt's unconscionable attempt to force a conveyance to him of debtor's property at a tenth of the value of part of its physical property and a sixtieth on earnings, are undisputed, and the Trustee not alone strenuously advocates the allowance of Brynoldt's wholly invalid claim of $29,316 for rent, (of property which he never owned), but besides, makes Brynoldt the

Page

favorite creditor and controlling figure on the Board of Directors of the reorganized company, a plain breach of his duty toward the stockholders..... 10

VI.

The proposed reorganization is most unjust and unfair to the stockholders in two respects..... 11

Conclusion 13

TABLE OF CASES CITED.

Dudley v. Mealy, 147 F. (2) 268, 272..... 11
Eastman Co. v. So. Pac., 273 U. S. 359..... 7
Puget Sound Power and Light Co. v. City of Puyallup, 51 F. (2), 688, 694..... 6
U. S. v. Beth. Steel, 315 U. S. 328, 329..... 9

MISCELLANEOUS.

Jones on Ev., 2d Ed., §1045, p. 1847..... 7
Jones on Ev., 3d Ed., §272, p. 405.....9, 10
30 C. J. S., § 104, p. 506 7
Gerdes, §§348, 349, 356, 390, pp. 536, 537, 545, 586..... 11
Gerdes, §§348, 456, pp. 536, 537, 545..... 11
1 Gerdes, §390, p. 586..... 11

Supreme Court of the United States

October Term, 1945.

No. 359.

STOCKHOLDERS' COMMITTEE OF THE
UNIVERSAL LUBRICATING
SYSTEMS, INC.,

Petitioner,

vs.

AUSTIN L. STALEY, Trustee in Reorganization for the Universal Lubricating Systems, Inc.

REPLY BRIEF.

To the HONORABLE HARLAN FISKE STONE, CHIEF JUSTICE, *and the Associate Justices of the United States Supreme Court:*

The controlling issue herein is whether Universal Lubricating Systems, Inc., (hereinafter called Universal), is solvent, which depends on—

(1) whether the valuation should have been on earnings;
(2) whether two claims of Universal, one against Stewart-Warner Corporation and the other against Christian Brynoldt, should have been valued;
(3) whether a patent belonging to the Universal company should have been valued; and
(4) whether the valuation made by the Master and approved by the two courts below, was correct.

The Trustee, in his brief, quotes and relies on the opinion below, and the questions raised by him will be briefly answered.

I.

The Master and the two courts below erred in refusing to value Universal on earnings. All the evidence required such a valuation.

The court below stated as its reasons for refusing to value on earnings,—

(a) "The * * * corporation * * * since 1932 and up to 1941 lost money every year but one." * * * the Special Master stated that "the losses may have been due to litigation with Stewart-Warner, though he did not so find as a fact." (Opinion, p. 5.)

The proof clearly shows that no real losses occurred during these nine years but that the apparent losses were in effect and should be considered profits. We quote the evidence as follows:

1. Kalish, the attorney for Universal, states that it lost $2,000,000 through Stewart-Warner's unfair competition. (App. 125a, 130a.)
2. "* * * that litigation" (Stewart-Warner), "extending over a number of years, has occasioned the expenditure of a great amount of money." (Plan, p. 4.)
3. This admission by the Trustee and the testimony by the attorney are undisputed, and they are conclusive that the 1932 and 1941 losses were from unfair competition, and not a recurring loss or due to the business, (Jones on Evidence, 2d Ed., §1005, p. 1847), but are the equivalent of an annual profit for the 9 years of over $200,000 a year, instead of a loss as the court below mistakenly states.

(b) In continuation of standing up under a loss of $200,000 a year through unfair competition, equivalent to a profit of that much per year, Universal under the disadvantage and expense of bankruptcy, has continued to earn large profits, adding to the proof which, all of it, requires a valuation on earnings.

1. For 1943, the profit was $151,008.42;
   For 1944, the profit was $124,046.56;
   From May 1941 to Sept. 1944, 3½ years, the profits were ..... $196,625.72.
2. The claims not disputed by the Trustee amount to ..... $397,927.61.
   The dividend on the preferred stock, at 6% will amount to less than ..... $ 24,000.00.
   So, on the average of earnings for the past two years, (much more on the $200,000 for the 9 years from 1932 to 1941), the earnings will amount to over 5 times the requirements for preferred stock dividends.
3. The increase in net worth in the 3½ years of bankruptcy has been such as to require a valuation on earnings. When the order adjudging Universal a bankrupt was made,—
   the debts were $331,661.18;
   the assets were ..... $ 63,909.16,
   (Schedules in Petition for Bankruptcy).
   The present value of the physical assets, not counting the Stewart-Warner or Brynoldt claims or the patent, concededly amount to ..... $327,000.00.
   Debts admitted by the Trustee are ... $397,927.61.
   So, in a short period, 3½ years, despite the expense of bankruptcy and the inefficiency inseparable from it, the assets have grown five times as high as they were when Universal was adjudged a bankrupt, while the debts have increased only 1/5th beyond what they were then. (Amended Plan, p. 5.)

(c) Next, the court below mistakenly held that,—

"* * * such prospects," (good prospects for the business and increased production through installing more

efficient machines), "do not furnish an argument for capitalization of earnings to show present worth when the earnings have come under the highly artificial stimulus of war production and an unusually favorable tax situation."

1. The general prospects of Universal's business are very exceptionally promising. To save referring to the findings of the Master, they are repeated here as follows,—

"there is a probability that in the future there will be a great and increasing need of lubricating devices such as are manufactured by debtor, and for similar equipment." (July M. R., Para. 13, p. 29a.)

"* * * the Trustee thinks that by buying one machine at a time and selling some of the old ones, a modern plant would be built up which would have a small but profitable business and be able to compete with any competitor at any price." (*Id.*, Para. 15, p. 30a.)

"The industrial business has recently been profitable * * *." (*Id.*, Para. 11, p. 28a.)

"The evidence shows grounds for expecting success for the reorganized company if it has adequate working capital." (*Id.*, Para. V, p. 50a.)

"The prospects for the entire line of fittings including this coupler are a great deal brighter than they were at the time of the previous hearing." (Oct. M. R., Para. 4, p. 62a.)

"In the Trustee's opinion, if there is a prompt reorganization and building up of the key personnel, the company will have profitable operations to such extent as to be able to maintain dividends on the preferred stock and possibly to pay it off over a period of years." (*Id.*, Para. 7, pp. 63a, 64a.)

2. There is a special reason why the earnings will be much greater in the future than in the past:

Universal's profits in the future should be 5½ times as great as they have been in the past, owing to the fact that new machinery (which has been partly and will be wholly acquired), is that much more efficient. (July M. R., Para. 14, p. 30a; Oct. M. R., Para 6, p. 63a.)

3. The objection of the court below to capitalization on recent earnings, that there had been an especially favorable tax situation, is not well taken:

Tax credit for 1944 was about	$ 70,000.00,
and as the earnings for the 2 years of 1943 and 1944 averaged	$135,000.00,
a year, a net profit of	$ 65,000.00
would have remained if the taxes had been paid, and as the debts amounted to only	$400,000.00,
and the dividends to only	$ 24,000.00,
the profit of $65,000 remaining would have paid the dividends in full and left	$ 41,000.00
to redeem preferred stock.	

Moreover, the court will take judicial notice that a new bill reducing taxes, especially for small businesses, is about to be passed, which the court below should have taken into account and not have considered simply present high taxes.

4. Nor was the objection of the court below that the earnings of 1943 and 1944 "have come under the highly artificial stimulus of war production" well taken:

> As the far larger part of the manufacturing of the country was of war munitions these years, if that were an objection to valuing on earnings, there would be practically no valuations on earnings in the country. Moreover, as appears from the findings of the Master quoted above, under (a), Universal will have far more business than it had during the war.

(d) The court below concedes that the capitalization should have been on earnings except for the two objections described above, and as they are both invalid, the effect of the opinion, (disregarding them), is to find that earnings should have been adopted as the measure of the value of Universal's property.

(e) That the valuation should have been made on earnings is made additionally clear by the fact that the failure to use

earnings as a measure of value was in conflict with all of the findings in the case; and the court below had no new facts upon which to decide contrary to the findings of the Master and the allegations of the Trustee and the evidence of the only witness.

The Trustee, the Master and the witness all knew the facts as to the government business and as to taxes, but none the less were of the opinion that the reorganized company would be really prosperous. Instead of the loss of government business being a damage, it may well be a marked advantage: it is established in the evidence and findings that there will be an abundance of Universal's kind of business,—that it will be a seller's market and not a buyer's,—and prices and profits will not be limited but will be subject only to agreement and naturally be high, and there will be no renegotiation.

(f) The refusal to value on earnings was vital since, taking the average of earnings of $135,000 a year for 1943 and 1944, at ten times this amount, the value of Universal's property would be $1,350,000,—3 times the aggregate of the debts, (*Puget Sound Power and Light Co. v. City of Puyallup*, 51 F. (2), 688, 694).

II.

It was a vital error to "extinguish" the Stewart-Warner claim, and providing that the present stockholders own the claim subject to payment of Universal's debts is far from curing the damage, as the claim, through being "extinguished," became unavailable on the asset side to determine the real issue here,—that of solvency of Universal.

(a) The court below bases its refusal to value the Stewart-Warner claim on the following mistake of fact,—

"We have not, of course, the faintest notion of the strength of the debtor's case nor the defendant's defense in the forthcoming litigation."

1. The court was fully advised that the debtor has an unusually strong case. Universal's attorney states that it lost $2,000,000 through Stewart-Warner's unfair competition, (App. 125a, 126a, 130a), and that he is entirely satisfied that he "can prove liability up to the hilt." (*Id.* 127a.)

2. The District Court has authorized the Trustee to spend the money necessary to continue this litigation. (July M. R., Para. 20, p. 32a; Oct. M. R. IV, p. 72a.)

3. The District Judge and the Circuit Court of Appeals both recognized the probability of recovery by the debtor,—the District Judge by providing how the proceeds should be distributed, and the Circuit Court of Appeals by affirming the provision. (App. 132a, 133a, 104.)

4. The Plan states,—

"* * * recent decisions on the primary questions involved in that litigation have been favorable to debtor, and *there is every reason to expect there will be a substantial recovery by the debtor's Trustee in the final stages of that litigation.*" (Plan, p. 4.)

This allegation in the plan, (the Trustee's Pleadings), is conclusive evidence, (*Jones on Ev.*, 2d Ed., §1045, p. 1847.)

5. On the proof, debtor is entitled to recover $2,000,000, and the presumption in equity is that it will recover the amount due it. (*30 C. J. S.*, §104, p. 506.)

6. As the Stewart-Warner acts were wrongful, only the best proofs available will be required. (*Eastman Co. v. So. Pac.*, 273 U. S. 359.)

(b) The court below erred in holding that,—

"* * * there was no error in not including this claim in the evaluation of debtor's property and that the provi-

sion made for the disposition of the net proceeds is both fair and feasible."

The real and controlling issue here is whether Universal is solvent, and the refusal to value this claim made it impossible to add the amount at which it should have been valued to the asset side of debtor's property; and again the error was vital because any fair valuation of this claim would have shown the debtor to have a large surplus beyond being solvent.

III.

Debtor's claim against Christian Brynoldt for damages for slander of title is covered by the petition and original brief, and therefore will not be discussed here. (Petition, p. 2; Orig. Brief, pp. 20, 21.)

IV.

The court below approved the Plan, but made no separate finding as to the claim of Christian Brynoldt, which the Master allowed at $71,011.35, (App. 23a), a large part of which is clearly invalid.

(a) After Universal had suffered huge losses through Stewart-Warner's unfair competition, in 1936 it obtained loans from Brynoldt who exacted an agreement that if his loans exceeded $20,000 all debtor's machinery, materials, and manufactured stock would become the property of Brynoldt. In 1937, his indebtedness exceeded $20,000, whereupon he exacted a bill of sale of all this property and a lease from debtor of its own property for 3 years and 11 months, at $500 per month plus 6% interest, amounting, without the 6%, to $23,500, the total of his loan. (Plan, p. 49.)

The property claimed consists of 148 items, (Plan p. 55), and is practically the same as that which the Master found worth $327,000. Brynoldt acquired besides, title to a patent belonging to debtor and 75 shares of preferred and 3800 shares of common stock,—all, so far as appears, for the $23,500. (*Id.*) Brynoldt and his attorney, with a third person, filed the petition in bankruptcy.

(b) As Brynoldt knew that Universal was heavily encumbered with debt, equity will relieve Universal from its bill of sale on account of the advantage taken and the hardship inflicted. (*U. S. v. Beth. Steel*, 315 U. S. 328, 329.)

(c) The Trustee recognizes the rule in the case last cited:

> "The Trustee believes that there is but remote possibility that Brynoldt could establish his claim of absolute ownership." (July M. R. p. 34a.)

(This is a conclusive admission that Brynoldt's claim of title was baseless. *Jones on Evidence*, 3d Ed., §272, p. 405.)

(d) As the title to the patent depended on the same gross want of consideration as that of the other 148 items of property, it will revert to and become a part of the debtor's assets.

(e) Despite the fact that the bill of sale is invalid and that no rent could accrue under the lease, the Master allowed Brynoldt his baseless claim for rent at ..... $29,316.00.
This should be subtracted from the $71,011.35,
which would leave the claim $41,695.35,
which would be offset by the debtor's claim of damages for slander of title.

(f) Despite the fact that this gross attempt at over-reaching by Brynoldt was fully covered by the stockholders' brief in the court below, and fully argued orally, the court below fails to say a word on the subject, which is wholly inexplicable.

V.

All the facts as to Brynoldt's unconscionable attempt to force a conveyance to him of debtor's property at a tenth of the value of part of its physical property and a sixtieth on earnings, are undisputed, and the Trustee not alone strenuously advocates the allowance of Brynoldt's wholly invalid claim of $29,316 for rent, (of property which he never owned), but besides, makes Brynoldt the favorite creditor and controlling figure on the Board of Directors of the reorganized company, a plain breach of his duty toward the stockholders.

(a) "The trustee believes that there is but remote possibility that Brynoldt could establish his claim of absolute ownership." (July M. R., p. 34a),

a conclusive admission that Brynoldt's claim of title is baseless. (Jones on Evidence, 3d Ed., §272, p. 405.)

Yet, in face of his own admission that Brynoldt had no title to Universal's property and of course could not lease what he did not own, the Trustee not alone advocates the allowance of $29,316 for rent, but terms the stockholders very proper attack upon it, "senseless." (Trustee's Brief, p. 13.)

(b) Moreover, despite Brynoldt's unconscionable attempt at over-reaching Universal, (continued in this Court by the attempt at justification of the invalid claim for rent), and despite Universal's claim against Brynoldt for slander of title and the adverse interest of the parties growing out of their claims, the Trustee makes Brynoldt the favorite over all other creditors by proposing to pay him, alone, about one-half of his padded and invalid claim in cash, and also makes him the controlling figure on the Board of Directors by making him personally, and his attorney, and the

Trustee, (the brother of his son-in-law), all directors of the reorganized company, (Plan, pp. 13, 14), in conflict with his duty as trustee towards the stockholders who still, even under the decision below, remain the owners of the Stewart-Warner claim, subject only to the lien of the creditors for payment of their claims. (Gerdes, §§348, 349, 356, 390, pp. 536, 537, 545, 586.)

(c) The Trustee failed in his duty toward the stockholders in that,—

1. He alone, without creditors support except that of Brynoldt, has advocated the invalid rental claim of Brynoldt, whereas his duty was to be impartial. (1 Gerdes, §390, p. 586.)

2. He improperly selected Brynoldt, with large interests adverse to those of the stockholders, as a director, as well as Brynoldt's attorney and the trustee, himself, (a brother of Brynoldt's son-in-law). (*Id.*, §§348, 456, pp. 536, 537, 545, See also *Dudley v. Mealy*, 147 F. (2) 268, 272.)

VI.

The proposed reorganization is most unjust and unfair to the stockholders in two respects,—

(1) In making the stockholders the owners of the Stewart-Warner claim, and yet depriving them of any control over its enforcement, but putting that in the unrestricted control of the Trustee; and

(2) In providing that, if the creditors are paid in full from the proceeds of the Stewart-Warner claim, they shall be made a gift besides, of all debtor's property, (worth in physical assets alone, approximately $400,000, and on earnings, $1,350,000).

(a) The effect of the decision below as to the Stewart-Warner claim is to make the present stockholders the owners, subject to a lien of the creditors for payment of their claims. The attorney in the case estimates the damages at

$2,000,000, which would be trebled, and states that he "can prove liability up to the hilt." So, the claim is a very large one, and the stockholders are vitally interested in the suit being conducted in the best manner possible for their interests.

> Despite their ownership, the stockholders are deprived by the Plan of any control whatsoever over the case. Instead, the Trustee is given unrestricted control of it, personally and quite apart from the Directors of the reorganized company. (Plan, p. 17.)
>
> In view of the unconscionable attempt of Brynoldt to acquire Universal's property at a tenth of the value of part of its physical property or a sixtieth on earnings, by converting a loan into a sale, and the Trustee's persistent and strenuous advocacy of Brynoldt's invalid claim for rent and his making him a favorite creditor and the controlling figure on the Board of Directors, the stockholders do not feel that their interests are safe in the Trustee's hands or that they should be excluded, (as they are), from any control or direction of the Stewart-Warner litigation.
>
> The stockholders, as the Trustee states, suffered "the expenditure of a great amount of money," (Plan, p. 4), in the Stewart-Warner litigation; for 9 years they were deprived of any dividends; and then their company was forced into bankruptcy. The recovery of the unjust damage sustained by them is their chance to recoup for the prolonged injuries they have suffered. Under such circumstances they themselves should be given a chance to protect their interests in this litigation.

(b) If enough is realized, the creditors will be paid in full from the proceeds of the Stewart-Warner claim. Yet, they will, under the Plan, become in addition the owners of all

debtor's property, (aside from the balance of the Stewart-Warner collection), worth, capitalized on earnings, $1,350,000,—three times the amount of their claim. This would be an outright gift.

There is no reason for the creditors receiving anything more than full payment, since their position is not made less secure, but far more so through the plan of reorganization. They, through preferred stock, will have the first lien on earnings of the company and, besides, they are given a specific lien on the Stewart-Warner claim which is for five times the amount of the debts.

There is no justification for the attempt to make the creditors a gift of all debtor's property besides paying their claims in full.

Conclusion.

1. The proof here requires a valuation on earnings, in accordance with the oft repeated rulings of this Court, viz,—

The objections of the court below were, that there were losses from 1932 to 1941, but

The proof shows clearly that these were, in effect, not losses but profits, due to unfair competition.

Next, the court below said—"the average profits of $135,000 a year for 1943 and 1944 were not a measure for capitalization, because of the artificial stimulus of war production and a favorable tax situation", but,—

The Master's findings, the Trustee's statements, and a highly competent witness, all testify that the pros-

pects of the business are most promising; that it would have more rather than less business, not subject to profit restrictions, with a seller's not a buyer's market, and higher prices; and if the taxes had been paid, the remaining profits would have paid the preferred dividend and leave a large surplus; and a new bill reducing taxes for small businesses will undoubtedly be passed within a few weeks.

Debtor's large earnings have been despite the inefficiency and expense of bankrupt operation, emphasized by the court below, and despite the expense of the Stewart-Warner litigation.

2. The court below based its refusal to value the Stewart-Warner claim on its not knowing the strength of the debtor's case or the defendant's defense, whereas it was fully advised by Universal's attorney that he "could prove liability up to the hilt," and that debtor's losses through unfair competition were $2,000,000; the District Court has authorized the expenditure to continue the litigation; and the two courts below provided for distribution of the amount of recovery; and the Plan states,—

> "There is every reason to expect there will be a substantial recovery * * * in the final stages of that litigation,"—

conclusive evidence.

3. Brynoldt attempted to obtain title to debtor's physical assets, worth as such about $400,000, and on earnings $1,350,000, for $23,500. The Trustee states—

> "There is but remote possibility that Brynoldt could establish his claim of absolute ownership."

4. The courts below sustain the claim of Brynoldt for rent of this property, which he never owned. His whole effort to overreach was abortive. The court below sustained this wholly invalid claim for rent.

4. The Trustee has strenuously and persistently advocated, contrary to his duty, Brynoldt's invalid claim for rent, and despite Brynoldt's adverse interest, has made him, his attorney, and the trustee himself, (a brother of Brynoldt's son-in-law), directors of the reorganized company, and provided that Brynoldt, alone, of all the creditors, should be paid half his padded and invalid claim in cash,—a failure of duty to the stockholders.

5. Two proposals are wholly unjust,—(1) that the creditors be paid in full from the proceeds of the Stewart-Warner claim, and if they are so paid, they receive besides, all debtor's physical property, (except the balance of the proceeds of the Stewart-Warner claim) worth as such $400,000, and on earnings $1,350,000; and (2) the provision that the present stockholders be the owners of the Stewart-Warner claim, subject only to payment of the creditors' claims, but excluding them from any voice in the Stewart-Warner action, whereas they feel no confidence in the trustee's conduct of it, in view of his advocacy of Brynoldt's rental claim and his preference of Brynoldt otherwise.

For all these reasons, it is respectfully urged that certiorari should be granted and the judgment of the court below be reversed.

Dated: September 24th, 1945.

Respectfully submitted,

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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 359.

STOCKHOLDERS' COMMITTEE OF THE UNIVERSAL LUBRICATING SYSTEMS, INC.,
Petitioner,

vs.

AUSTIN L. STALEY, Trustee in Reorganization for the Universal Lubricating Systems, Inc.

PETITION FOR REHEARING OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

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BATAVIA TIMES, LAW PRINTERS,
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SUBJECT INDEX.

Page

Statement 2

Reasons for Rehearing 6

I.

As a result of the declaration by Congress of the necessity of saving the common stockholder to insure the continued operation of existing corporations and to bring about the organization and operation of new companies, through the furnishing of the necessary capital (which will not be supplied if court decisions unnecessarily and, still more, arbitrarily wipe out common stock investment), this proceeding is demonstrated to be not simply a private one between parties but one where the Congress has declared,

(a) The purpose of the reorganization act to be to continue business through existing stockholders;

(b) The public necessity for such continuance in the constant need of operating capital; and

(c) The methods by which to attain this most necessary result.

So, as a result, there is aligned on the side of Petitioners, representing the stockholders, Congress, with its declared purpose to save them, and the great purpose to avoid and to minimize the effect of depressions, making this a major conservation measure 6

II.

Congress has not stopped at declaring its purpose as to reorganizations in a report and by pass-

II.

Page

age of the House bill and in debates, but has formed a special committee to study the needs of and to promote the prosperity of small business, and has provided as well for making necessary loans to it. This committee has been tireless in its efforts to aid small business, but the cooperation of the courts is necessary to make its measures effective, and the decision below is extremely harmful to the Congressional purpose and efforts 13

III.

Petitioners rely on their original brief for the Statement of Facts and their Argument as to the merits of the case as a private one between the parties, and will refer only in the briefest way here to those matters.

The decision of the Court below is in direct and irreconcilable conflict with the purpose of reorganization as declared by Congress and should be reversed for that reason and in the public interest, —to minimize and repel depressions, to secure capital to enable factories to operate, and to keep labor employed,—none of which is given any consideration by the Court below.

The decision below is in conflict with the findings and the evidence, and its decision is injust and inequitable, and certain of its provisions are in conflict with basic law. For these reasons also the decision below should be reversed 1

IV.

The decision below is most unfair, unjust and inequitable 2
Conclusion 2

Table of Cases.

	Page
Cons. Rock Co. v. DuBois, 312 U. S. 510, 522, 523	20, 21
In re Western Pac. R. Co., 124 F. (2) 136, 138, 139	20, 21
Otis & Co. v. Securities Exchange Comm., 89 L. Ed. 460	12
Puget Sound Power & Light Co. v. Puyallup, 51 F. (2) 688, 694	17
U. S. v. Bethlehem Steel, 315 U. S. 328, 329	21

Statutes Cited.

Bankruptcy Act	2
Chandler Act	3

Other Authorities.

Congressional Record:	
August 10, 1937, p. 1189	7
February 14, 1945, p. 1123	8, 10
February 14, 1945, p. 1124	10, 18
February 14, 1945, pp. 1124-5	8, 10
February 14, 1945, p. 1125	9, 10
February 14, 1945, p. 1126	8, 9, 22
February 14, 1945, p. 1127	8, 12
C. R. Senate, June 10, 1938, p. 8680	7
Report 48, 79th Cong. 1st Ses.	9, 12
pp. 6 and 7	11
3 Am. Jur. 481	17, 19
50 Am. Jur. §223:	
pp. 201, 202	24
pp. 202, 203	24
5 C. J. S. 777	17, 18
Jones on Evidence, 2d Ed. §1045, p. 187	20

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AUSTIN L. STALEY, Trustee in Reorganization for the Universal Lubricating Systems, Inc.

PETITION FOR REHEARING OF PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable, the Chief Justice of the United States and Associate Justices of the Supreme Court of the United States:

Petitioner, a Stockholders' Committee, respectfully request a rehearing and a reconsideration of their Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Third District, which was denied by this Court on October 8, 1945.

Statement.

Petitioner respectfully asks a rehearing herein on the ground that a paramount public interest is involved to which, because unaware of it, reference was not made in the original petition, a lack of knowledge, however, shared apparently by all other members of the bar, as counsel is unable to find any reference to it in other briefs,—and so the Court, through its not being urged, has never referred to it in its decisions, so far as counsel is able to find.

The case is one arising under the reorganization provisions of the Bankruptcy Act. The question at issue is whether the debtor is solvent. The Court below found, wholly in conflict with the evidence, that it is insolvent and excluded the stockholders from participation in the new corporation.

The broad, general purpose of the reorganization act is to avoid depressions, minimize them when they exist, save stockholders and investors, and keep labor employed. The act has been so interpreted by the Congress, and its construction should be the controlling factor in the decision of reorganization cases. This intent of Congress to save business instead of liquidating it,—to keep it in the hands of stockholders trained for management and skilled through experience, instead of turning it over to security holders who are merely investors and untrained and inexperienced, —was of vital importance in the prolonged and extreme depression immediately preceding the late war, and will be of equal value and importance in the present reconstruction period when we are to have, as it is estimated, 8,000,000 men temporarily, indefinitely unemployed.

So, Congressional construction of the act is that it should be interpreted and applied to continue business instead of

liquidating it, and to protect stockholders who have gone through prolonged depressions by enabling them to hold on till the prosperous days which Congress feels are sure to come.

In this major effort to protect against and to relieve from depressions the Courts play a necessary and most important role. While, generally, they decide only questions between private parties, here they have the rare and great opportunity and duty to render a great service to the country as a whole.

The views expressed by counsel are not simply his own but are based on the debates on the Chandler Act in the Senate and House, and on the report of the House Committee, and on debates in the House on the Hobbs Bill to more efficiently protect stockholders in railroad reorganizations,—the principles covered by the debate and report being equally applicable to other corporations being reorganized.

We quote at some length from the Congressional debates and report.

Debtor manufactured lubricating appliances but met persistent opposition to marketing by Stewart-Warner, which from 1932 to 1941 brought many patent suits against it, all of which have been determined favorably to debtor. The losses of debtor amounted to $2,000,000 (Ap. 92 a, 93 a, 125 a, 130 a). Afterwards, in May, 1936, debtor obtained loans from one Brynoldt, agreeing, if the loans exceeded $20,000, that all its property should be transferred to Brynoldt. In 1937 the indebtedness exceeded $20,000, whereupon Brynoldt claimed title and exacted a bill of sale and a lease by debtor for three years and eleven months

at $500 per month (Plan p. 49). The property claimed is practically the same as that which the Master found worth $327,000. Brynoldt sought to acquire besides a patent worth $40,000 and common and preferred stock. The Trustee believes there is but remote possibility that Brynoldt could sustain his claim to absolute ownership (July Master's Rep., hereinafter called M. R., para. 25).

The issue herein is whether debtor is solvent. The evidence was as follows:

Two valuations of part of debtor's physical assets were made,—the stockholders' valuation being $325,078.59, and the Trustee's $279,719.20.

The Master found the value $300,000 (July M. R. pp. 25 a, 26 a). From July to October debtor's physical assets increased $27,000 (Oct. M. R. pp. 60 a, 61 a). The claims admitted by the Trustee amount to $397,927.61.

The debtor has a suit for damages against Stewart-Warner for unfair competition, the facts as to which are stated and discussed under 5 of point III, herein-below.

The debtor also claims damages against Brynoldt for his unfounded claim of title to its property, thereby destroying its credit.

The Master and the Courts below have refused to value a coupler patent worth $40,000, paper title to which Brynoldt obtained in his effort to convert his loan into a title.

The Master, trial court and court below have refused to value Universal on earnings, the facts as to which are stated and discussed also under point III herein below.

The results from Trustee's operation of the business have been,—profits May, 1941 to September, 1944—$196,625; for 1943—$151,008.42; for 1944—$124,046.56.

New machines which have been installed to the extent of 40% and will be completely installed which will produce 5½ times as much material, at no added cost, as the obsolete machines.

The debtor's cash position and increase in assets are also stated and discussed under point III, herein below.

The Master allowed Brynoldt's invalid rental claim of $29,316. Taking this and the $40,000 value of the patent into account, the admitted claims and the physical assets, (aside from Stewart-Warner claim), are practically equal.

The Court below found debtor insolvent.

Debtor has 35,000 shares of common stock, at par value of $1.00 per share, and 2150 shares of preferred stock, at par value of $100 per share (Plan p. 5). The reorganized company would have 4,000 shares of preferred stock, at no par value, and 15,000 shares of common stock, at no par value (*id.* p. 11).

Brynoldt, including his invalid rental claim, was found to have a total claim of $71,011.35 (Ap. 23 a), for which he is to receive $35,000 in cash and the balance in preferred and common stock (Ap. 22 a, 23 a, 24 a), and the new company is to have seven directors, including Austin L. Staley, the present Trustee, whose brother is the son-in-law of Brynoldt, Christian Brynoldt and Henry Bergstrom, his attorney (Plan p. 14).

The creditors are to receive one share of preferred capital stock of the new company for each $100 of their claims, plus one share of common stock (Plan p. 20).

The District Judge affirmed the Master's report, except that he directed that the proceeds of the Stewart-Warner litigation be paid to the reorganized company to the amount needed to retire its preferred stock,—the balance to be distributed among debtor's present preferred and common stockholders (Ap. 132 a, 133 a).

REASONS FOR REHEARING.

I.

As a result of the declaration by Congress of the necessity of saving the common stockholder to insure the continued operation of existing corporations and to bring about the organization and operation of new companies, through the furnishing of the necessary capital (which will not be supplied if court decisions unnecessarily and, still more, arbitrarily wipe out common stock investment), this proceeding is demonstrated to be not simply a private one between parties but one where the Congress has declared,

(a) The purpose of the reorganization act to be to continue business through existing stockholders;

(b) The public necessity for such continuance in the constant need of operating capital; and

(c) The methods by which to attain this most necessary result.

So, as a result, there is aligned on the side of Petitioners, representing the stockholders, Congress, with its declared purpose to save them, and the great purpose to avoid and to minimize the effect of depressions, making this a major conservation measure.

(*a*) ***Congress has repeatedly, clearly and most emphatically declared that the purpose of the reorganization act is to continue and not to liquidate business,—to save the investment of the common stockholder, as being in the public interest.***

"The public has an interest in saving a valuable business * * *." (Mr. Chandler, Congressional Record ((hereinafter called C. R.)) Aug. 10, 1937, p. 1189.)

"The theory now is to conserve rather than liquidate the estate, giving the debtor a chance to work out his financial difficulties and not destroy his business. * * * 'It' (bankruptcy) 'means that when financial evil days come upon one, he may seek the aid of the bankruptcy court of the United States and by this method may keep his creditors at bay until he has had time to gain his financial equilibrium. Possibly he may remain in possession * * * until his creditors are brought to a realization * * * that * * * it is better for the bankrupt and for the country if the bankrupt is permitted to continue in his business * * *.' (Michener, a member of the Committee, *id.*)

"A striking characteristic of the amendatory acts which were passed after 1932 was that they were all passed upon a desire to preserve business and to prevent liquidation as far as possible. The old theory * * * was that when the debtor, * * * entered the bankruptcy court his assets were to be marshaled for the benefit of his creditors. He surrendered everything he had, went out of business and then sought to rebuild his fortune as best he could in some other line.

"However, with changing circumstances, * * * it became obvious to those who were administering the bankruptcy laws or practicing under them, to those who were seeking to rehabilitate business, that a different form of procedure was essential.

"On March 3, 1933, there was enacted what is now chapter VIII of the bankruptcy law. This was the first effort to make it possible for a debtor to pay his debts upon the installment plan, as it were, and to continue in business instead of going into liquidation." (O'Mahoney, C. R. Senate, June 10, 1938, p. 8680.)

"You need no better illustration of the importance of the railroads", (and equally the manufacturers), "to the public than the job that has been done by the railroads of this country", (and equally by the manufacturers), "since the war,—not only the so-called solvent railroads", (or manufacturers), "but those * * * undergoing reorganization * * *." (Reed of Ill., C. R. Feb. 14, 1945, p. 1123, Committee member.)

"It is strange * * * that the Commission, * * * has not recognized the importance to the public of protecting the existing investment, and it is even stranger that the courts have permitted the Commission to get away with it. (*id.* pp. 1124-5.)

"The purpose of the Bankruptcy Act, particularly of sec. 77, was to relieve debtors of some of their burdens, not of all of their property.

"The passage of this bill is necessary *now* in order to save the equities owned by thousands of *bona fide* owners of railroad", (manufacturing), "stock and junior bonds. It is also necessary now if we would save railroad", (manufacturing), "credit, without which railroad", (manufacturing), "service in the post-war period will be seriously impaired." (Hobbs, C. R. Feb. 14, 1945; p. 1126.)

"I feel that this bill is in the public interest.

"* * * the court should have a larger part in the review of these cases than they have had under the interpretation of the Supreme Court. This will give it to them, and, in my opinion, represents a just remedy." (Kefauver, *id.* p. 1127, Committee member.)

(b) The Congress, too, has pointed out as the reason for preserving the investment of the common stockholders that existing corporations constantly need new capital for expansion and new corporations to enable them to start, and if common stockholders' investments are unnecessarily destroyed the supply of capital necessary to enable the corporations to operate will not be furnished,—labor will not be employed and depressions will be accentuated instead of being minimized.

"* * * yet in nearly every plan which it," (the Commission), "has brought out it has defeated it's purpose by wiping out the stocks, and thereby forever destroying the market for railroad stocks as investments." (Reed of Ill. C. R., Feb. 14, 1945, p. 1125.)

"We must have railway credit to enable our transportation system," (our manufacturing), "to maintain itself * * *. In war it has been the first line of defense for without transportation" (equally without manufacturing) "there would have been no material sent to the army * * *." *(id.* p. 1125.)

"National need of adequate railway," (manufacturing), "service requires the protection of the investment of both Wall Street and Main Street in railway," (manufacturing), "securities."

"Security must mean complete assurance for the high-priority mortgage-bond investors, and at least reasonable assurance for the investors in common stock and bonds of lower priorities. Otherwise fewer, (factories),railroads will run and those that run will operate inadequately. Each of these deplorable results means fewer jobs for railroad," (manufacturing), "men and lower wages for labor as well as management." (Hobbs, C. R. Feb. 14, 1945, p. 1126.)

"If the transportation system" (the manufacturing) "of a country is to be adequately financed, investment in railroad" (manufacturing) "securities must be kept attractive for private investors. It is folly to expect investors to finance new railroads" (new manufacturing) "by purchasing stocks or junior securities which may be arbitrarily eliminated." (Report 48, 79th Cong. 1st Ses.)

"We cannot have a transportation system" (or manfacturers), "in these United States unless we show some willingness to protect the man who puts his money into it, not merely the banker * * * on the bonds, but the little fellow who buys the stock. We must keep the railway" (manufacturing) "investment attractive for stockholders. It is folly to expect them to finance new

railroad" (manufacturing) "capital by wiping out the investments they have already made." (Reed of Ill., C. R. Feb. 14, 1945, pp. 1124-5.)

(c) The Congress also points out the procedure to be followed to protect the common stock investor in the consideration of evidence and in the provisions of the judgment,—holding that value must be determined on earnings and that the earnings should not be not simply those of the late depression period but that present and prospective earnings should be given due weight, and that in the final judgment or order the common stockholder can and should be given no-par new stock which would be in no way detrimental to security holders with prior rights, as this new stock would be without dividends in years when not earned but would pay dividends in prosperous years.

"One of the elements of this valuation was required to be due consideration of the earning power of the property, past, present, and prospective, and all other relevant facts." (Reed of Ill., C. R., Feb. 14, 1945, p. 1123.)

"It never was intended that these depression earnings should be used as a measure of earning power, and, therefore, a measure of value."

"What is the result? In considering past, present, and prospective earnings, the Commission has put the accent, not on the past earnings, but on the depression earnings, and has failed to temper its judgment by any fair conception of prospective earnings." *(id.* p. 1124.)

"If the earnings are there, the new no-par stock will get it. It cannot harm the bondholder, who is secure in his earnings and who is paid in full before the stockholder participates." *(id.* p. 1125.)

In order to carry out the policy, however, of having fixed interest charges reduced, the bill contains a proviso in sec-

tion 1 (ii) that, if the existing capitalization is in excess of the value of the debtor's property as certified by the Commission under subsection (e)—that is, of what the Commission terms "capitalizable value"—the excess shall be represented by no-par stock issued at the rate of one share for each $100 of such excess. The purpose of this is to afford to the existing stockholders and junior security holders a continued interest in the property. This no-par common stock will still represent actual investment in the property and will still represent a value which the Commission itself has determined under section 19a. It will in no sense be a speculative medium. In bad years, it will pay no dividends; in the good years it should reap the benefit of prosperity at least sufficient to compensate for what the investor has lost in the bad years. As the matter stands now, the investor has suffered through the bad years, and when prosperity has returned the procedure under section 77—originally designed as an act for the relief of debtors—has taken his investment and turned it over to his creditors. (Report #48, 79th Cong. 1st Session, pp. 6 & 7.)

(d) The Congress has further declared as the reason for providing the existing common stock investor with new no-par common stock that it believes that this country will be prosperous and that our application of this act should be on the basis that it will be prosperous, and that the common stockholder, who has gone through a long period of depression, should share in that future prosperity.

> "We recently went through the worst kind of a depression this country had ever seen and, naturally, a good many of the railroads" (and manufacturers) "went through bankruptcy. We are now on the mend. During the last few years the railroads" (and manufacturers) "have had pretty good earnings. If the stockholders are given a chance to hold on to their securities and not be wiped out, they will have an opportunity to get something back out of their investment."

"The railroads" (and manufacturers) "are going to do pretty well in this country for several years to come; and if a stockholder who has common stock can hold it, he has a good chance of getting back some part of his money at least. I am, therefore, in favor of the pending bill and urge its passage." (Gorski, C. R. Feb. 14, 1945, p. 1127.)

"* * * unless we are to admit that our efforts at readjustment after the war will be a failure, then we must insist that the owners of these securities now being confiscated should share in the prosperity which has come as a result of the war and in that which necessarily will follow in rebuilding the Nation's industries." (Report 48, 79th Cong. 1st Session.)

(e) This Court recently, in Otis & Co. v. Securities Exchange Comm., 89 L. Ed. 460, allowed common stockholders to participate in reorganization, based on prospective earnings for fifteen years wiping out $38,700,000 accumulated preferred dividends and furnishing dividends for the common stock thereafter,—an extremely liberal application of the protection Congress has said should be extended to common stockholders, but not stated to be based on the Congressional construction of the purpose of reorganization.

(The two opinions by Justice Reed and Chief Justice Stone are models of logic and literature. The question naturally arises whether the conflicting opinions of these two great Justices would not have been reconciled if the debates in the House and Senate and the Report of the House on reorganization had been called to their attention. However this may be, the considerate treatment of the common stockholders was sustained, which helps greatly to sustain the declared purpose and intent of Congress.

II.

Congress has not stopped at declaring its purpose as to reorganizations in a report and by passage of the House bill and in debates, but has formed a special committee to study the needs of and to promote the prosperity of small business, and has provided as well for making necessary loans to it. This committee has been tireless in its efforts to aid small business, but the cooperation of the courts is necessary to make its measures effective, and the decision below is extremely harmful to the Congressional purpose and efforts.

Debtor's business is a small one and Congress has not stopped in its efforts to aid small business at reports and debates and passing the House bill, but it has formed a special committee, called a "Select Committee to Investigate and Study Small Business," which has been as active as any committee in Congress in investigating and studying methods and means to promote and protect small business. In this effort it has issued weekly detailed accounts of its proceedings and of its resultant recommendations, and has provided an organization and the funds to make loans to them. Congress has made it plain that it regards small business as the backbone of the prosperity of the country and has demonstrated in every way its desire to protect and encourage it.

To make these efforts of Congress successful, the active, continuous, wholehearted support of the courts is necessary, without which the efforts of Congress can be helpful in only a very limited way. To give real effect to the beneficial purpose of Congress the wholehearted, continuous and tireless cooperation of the courts is necessary.

The decision below is a serious blow to the helpful efforts of Congress.

III.

Petitioners rely on their original brief for the Statement of Facts and their Argument as to the merits of the case as a private one between the parties, and will refer only in the briefest way here to those matters.

The decision of the Court below is in direct and irreconcilable conflict with the purpose of reorganization as declared by Congress and should be reversed for that reason and in the public interest,—to minimize and repel depressions, to secure capital to enable factories to operate, and to keep labor employed,—none of which is given any consideration by the Court below.

The decision below is in conflict with the findings and the evidence, and its decision is injust and inequitable, and certain of its provisions are in conflict with basic law. For these reasons also the decision below should be reversed.

(a) The decision below fails utterly to take into consideration the public nature and need of the reorganization statute. On the contrary, it emphasizes throughout stated but unreal objections to the stockholders sharing in the reorganized company, and fails to consider the facts showing them entitled to share.

(b) The refusal of the Court below to value debtor's property on earnings was in conflict with declared purpose of Congress, ((c) of Pt. 1 above), and with the Master's findings, and the evidence, as approved by the trial court,

and the grounds of the refusal are not sustained by any evidence, and the Court below was without jurisdiction to reverse the findings.

The grounds of the decision of the Court below on which it refused to value on earnings are stated by it as follows,—

1. "As to the years prior to the trusteeship, the special master stated that the losses may have been due to litigation with Stewart-Warner, though he did not so find as a fact." (Opinion, p. 5.)

This omits the following additional and conclusive facts:

"* * * litigation, extending over a number of years, has occasioned the expenditure of a great amount of money for incidental expenses and counsel fees, and losses of various kinds, * * * in that litigation * * *." (Trustee's Plan, top p. 4.)

"I believe defendant had suffered the amount of damages claimed in the amended counter-claim." ($2,000,000) (Appendix 130 a.)

2. The Court held,—

"We heard a great deal of argument about good prospects for the business. * * * All of this may well be true and we hope, for the sake of those engaged in the enterprise, that it proves to be true. It bears upon the question of the feasibility of any plan which contemplates the continuance of the debtor as a going business concern. But such prospects do not furnish an argument for capitalization of earnings to show present worth when the earnings have come under the highly artificial stimulus of war production and an unusually favorable tax situation." (Opinion, p. 5.)

So, its decision below was ultimately reached on two grounds,—that the findings as to the prospects and outlook of debtor must be overlooked because part of debtor's production had been war work, and because debtor had an unusually favorable tax situation.

The ruling that the prospects and outlook of the debtor could not be considered ignores the five special findings of the Master, based on undisputed evidence, that

> "there will be a great and increasing need of lubricating devices * * * manufactured by debtor";
> that "a modern plant would be built up which would have a small but profitable business and be able to compete with any competitor at any price";
> that "The evidence shows grounds for expecting success for the reorganized company if it has adequate working capital";
> that "The prospects for the entire line of fittings * * * are a great deal brighter than they were at * * * previous hearings";
> and that "* * * if there is a prompt reorganization and building up of the key personnel the company will have profitable operations to such an extent as to be able to maintain dividends on the preferred stock and possibly pay it off over a period of years." (Committee's original brief, p. 4.)

The Court below also ignored the testimony of the expert witness.

These findings and the evidence conclusively show that the reorganized company will have far more business than the debtor had in war time, and that it will be a seller's not a buyer's market and prices will, therefore, be profitable and will not be restricted, as war profits were.

While the Court below found that debtor's work during the war was under a highly artificial stimulus, it failed to find, and could not find on the findings or the evidence, that there would be any less business after the war or what the business would be.

The refusal to follow the repeated and strong findings that the debtor's prospects are most promising is in con-

flict also with the Congressional Report and the declaration by Congressman Gorski, (a member of the Committee), quoted under (d) of point I, hereinabove, in which it is stated,—

> "We must insist that the owners of these securities now being confiscated should share in the prosperity which has come as a result of the war and in that which necessarily will follow in rebuilding the nation's industries."

Moreover, as the findings as to prospects were approved by the trial judge, the Court below had no jurisdiction to find in conflict with them or to ignore them, but was bound by them (3 Am. Jur. 481; 5 C. J. S. 777).

The ground that debtor had an unusually favorable tax situation in 1943 is also untenable; if, instead of being exempt from Federal tax it had been obliged to pay at the legal rate, its tax would have been $70,000, but as it earned $151,000 it would still have had left over $80,000, and as the dividends on the $400,000 of preferred stock would amount to only $24,000 there would have been an excess of nearly $60,000 to apply on the principal of the debts.

The controlling importance of valuing on earnings instead of on part only of the physical assets is demonstrated by the fact that the net earnings for the past two years averaged $135,000 per year, and a valuation on earnings would show the value to be $1,350,000 (Puget Sound Power & Light Co. v. Puyallup, 51 F.(2) 688,694), over three times the amount of the debts admitted by the Trustee.

3. The Court below failed to take into consideration the following additional and highly important facts,—

In the first 3½ years of the trusteeship the debtor's assets have grown from $63,909.16 to $329,000, and its debts

have increased only from $331,661.18 to $397,927.61. (O. B. pp. 7 & 9.)

Its cash on hand grew from $118,478.21 in May, 1944, to $260,464.52 of current assets in December, 1944. It requires but $75,000 working capital and it has net cash on hand of $201,860.99.

4. In conflict with the purpose of Congress, the Court below, contrary to the findings and the undisputed evidence, rested its decision on,— (1) the erroneous supposition that the debtor lost money the nine years from 1932 to 1941, whereas the losses were not due to the business but to unfair competition and were, in effect, profit; (2) on erroneously overruling the oft-repeated findings of the Master that the company's outlook is marvelously bright; and (3) on a mistaken statement that, if the debtor had paid the regular Federal tax, in 1943 it would not have had the net income to pay its preferred stock dividends, whereas it had almost 3½ times that amount.

Even if there had been losses in the depression years from 1932 to 1941, they should not have been considered in determining whether to value on earnings, the declared purpose of Congress being as follows:

> "It never was intended that these depression earnings should be used as a measure of earning power and, therefore, a measure of value." (Reed, C. R. Feb. 14, 1945, p. 1124.)

It was error for the Court below to overrule the findings and the evidence approved by the trial judge, and especially so as there was no conflict whatever in the evidence,—

> "Ordinarily findings of a master or referee, having support in the evidence, are, like the verdict of a jury, conclusive on appeal * * *." (5 C. J. S. 777.)

"In most jurisdictions, the finding of a referee, a master, or a commissioner, approved by the trial court, is entitled to the same weight and credit and is as binding as a verdict by a jury or a finding by the court itself * * *." (3 Am. Jur. 481.)

5. The Court below also overruled the findings and the evidence in refusing to value the Stewart-Warner claim.

This claim was one for unfair competition. The record shows,—

"* * * recent decisions on the primary questions involved in that litigation have been favorable to Debtor, and there is every reason to expect there will be a substantial recovery by the Debtor's Trustee in the final stages of that litigation." (Plan, top p. 4.)

"I believe defendant has suffered the amount of damages claimed in the amended counter-claim * * *." ($2,000,000.). (Statement of Atty. for Debtor, App. p. 130a.)

"I am entirely satisfied that we can prove liability up to the hilt * * *." (*id.* 127a.)

"In all infringement suits that have gone to trial, we have secured decisions that Stewart-Warner's patents * * * are either invalid or not infringed." (*id.* 129a.)

The trial judge provided and the Court below approved a direction that the proceeds of recovery on this claim be used to retire the new preferred stock,—to pay the creditors in full,—and for distribution of the remainder to the present preferred and common shareholders (Opinion, pp. 3 & 4),—the necessary inference from this provision being that both courts regard this claim as one in which there will be a recovery sufficient not alone to pay all the debts in full, but to leave a substantial amount for the present stockholders.

The trial court has directed that the Trustee expend the amounts necessary for carrying on this litigation. (Master's Rep. pp. 32 a, 72 a.)

The statement in the plan that there will be a substantial recovery, as the plan is the pleading in the case, is conclusive and cannot be disputed. (Jones on Evidence, 2d Ed. §1045, p. 187.)

Moreover, the whole case was tried on this statement of the Trustee in the plan.

The Court below erroneously extinguished this claim on the ground that,—

> "* * * we have not * * * the faintest notion of the strength of the debtor's case nor the defendant's defense" (Opinion p. 4),

whereas it had all the evidence quoted above,—the opinion of the attorney in the case and the statement of the Trustee in the plan. (Cons. Rock Co. v. DuBois, 312 U. S. 510, 522, 523, *In re* Western Pac. R. Co., 124 F. (2d) 136, 138, 139.)

The claims not disputed by the Trustee amount to $397,927.61. The Master found a part of the physical property (not including the Stewart-Warner claim nor the patent) worth $327,000, making the excess of debts over value of part of physical assets $70,927.61.

The patent is concededly worth $40,000, Brynoldt's invalid rental claim is $29,316, making together $69,316. So there is really no difference between the value of part of the physical assets and the admitted debts. Moreover, the Stewart-Warner claim, on the evidence as stated above, is

surely worth several times the amount of any possible difference.

6. The Court below also erroneously refused to value a coupler patent worth $40,000,—an item of property to which Brynoldt attempted to acquire title through his unfounded claim to all of the debtor's property,—worth on earnings $1,500,000,—for a loan of $23,500,—an unconscionable bargain, from which equity will relieve on account of the advantage taken by him and hardship suffered by debtor. (U. S. v. Bethlehem Steel, 315 U. S. 328, 329.) The patent should have been valued and not "extinguished". (Consolidated Rock Products Co. v. DuBois, 312 U. S. 510.)

7. The Court also erroneously refused to value a claim against one Brynholdt for slander of title in claiming ownership of all debtor's property, in an unjust effort to convert a $23,500 loan into such ownership, part of the physical items of this property being worth $327,000, and all of it on earnings over $1,500,000 (O. B. pp. 2 & 3). There could be no finding of value except on a complete appraisal. (Cons. Rock Co. v. DuBois, *supra; in re* Western Pac. R. Co., *supra.*)

IV.

The decision below is most unfair, unjust and inequitable, in that,

1. It allows one Brynoldt a claim for rent of debtor's property of $29,316, although the Trustee concedes that he never owned the property (O. B. p. 22),—a wholly baseless claim.

2. Yet Brynoldt, who attempted to secure $327,000 worth of physical assets,—to say nothing of its earning value of

$1,500,000,—for $23,500, together with his attorney and the Trustee, a brother of his son-in-law, are made three of the directors of the new corporation, and Brynoldt alone, of all the creditors, is to be made a large cash payment.

3. The provision of the plan that the creditors shall be paid in full from the recovery in the Stewart-Warner suit and then be given all debtor's property, is unconscionable and indefensible. (O. B. p. 23.)

The statement of Congressman Hobbs, the author of the House bill, is peculiarly apposite to this unconscionable and indefensible provision of the plan,—

> "The purpose of the bankruptcy act, particularly of sec. 77, was to relieve debtors of some of their burdens, not of all of their property." (Hobbs, C. R. Feb. 14, 1945, p. 1126.)

4. Under the plan the stockholders remain the owners of the Stewart-Warner claim,—by far the largest asset of the corporation,—subject only to payment of the creditors, but exclusive control of the litigation is given to the trustee, with no privilege to the stockholders to see that their rights are protected and they justly feel, from the advocacy of the invalid Brynoldt rental claim by the trustee and the favoritism shown him, distrustful of his fairness toward the stockholders, and this provision is inequitable and unjust.

Conclusion.

As shown above, Congress has repeatedly declared that its intention and purpose is that stockholders shall continue in business so that manufacturers may obtain from the public the capital necessary to continue them in operation through reliance on the security of their loans, and

to avoid and minimize depressions and to keep labor employed and has diligently labored to accomplish this beneficient end through the appointment of a committee which has been tireless in this work and by providing for loans to small business. There can be no greater public purpose than this. To accomplish the end sought, the co-operation of the Courts with the Congress is necessary. The decision of the Court below is plainly in conflict with its oft-repeated declarations of its purpose by Congress.

The effort should have been in accord with the purpose of Congress to continue the stockholders in business, and this would have resulted from performance of its duty by the Court below to value debtor's plant on earnings,—a valuation required on debtor's whole history, on its being able to earn enough so that it *made* and through unfair competition in nine years lost $2,000,000.; and has made over $196,000 in three years of the expensive and inefficient management of a trustee; has earned an average of $135,000 per year for the past two years; and has undisputedly and on the findings and evidence the brightest kind of prospects for large earnings in the future. These prospects show that debtor's business will be greater than during the war period, which answers the contention of the Court below that the recent earnings should not be considered because of war conditions. Moreover, Congress has itself declared that the post war period is to have a continuance of war prosperity and that the rights of stockholders should be considered with reference to such conditions. (See subhead (d) of point I, p. 11, hereinabove.) And while the Court below laid stress on the debtor's favorable tax situation for the last two years, the tax situation for all corporations is, the court will take judicial notice, to be greatly improved over the provisions of the present tax law.

So far as counsel is able to find, the declarations by Congress of its purpose to save the common stockholder and continue business have never been called to the attention of the Courts and there has been no decision by this or any of the lower Courts in view of these declarations.

> "* * * the primary rule of construction of statutes is to ascertain and declare the intention of the legislature, and carry such intention into effect to the fullest degree." (50 Am. Jr. §223, pp. 201, 202.)

An opinion by this Court that the rights of common stockholders must be considered with the aid of the favorable intent of Congress, would be of incalculable value to the business world. To allow the opinion below to stand would beget doubt and uncertainty by investors as to the value of common stock, and would have just the opposite effect of that intended by Congress. It would, to a very considerable degree, defeat the intention of Congress and such a construction should not be adopted. (*id.* pp. 202, 203.) The extent of the harm which would result from allowing the decision below to stand, in view of the debtor being solvent and of the many unjust and unfair provisions of the plan, cannot be estimated, but would, beyond doubt, be very great.

For all these reasons, it is respectfully urged that a rehearing and certiorari should be granted.

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